

Working Group Concept Paper

Investment in Inclusive Finance in China

Introduction

The World Microfinance Forum Geneva (WMFG) is a neutral international association registered in Switzerland that promotes inclusive financial services. It assists high level stakeholders in their decisions with respect to investment in this sector. Stakeholders include investors, providers of financial services and regulators.

WMFG is creating a Working Group on Investment in Inclusive Finance in China. This draft concept paper describes the background to the initiative, its rationale and the form it will take. The paper is a document for discussion.

Background

A large part of China's population does not have access to the financial services they need. Dedicated rural financial institutions have been marred by inefficiencies and lack of effective outreach to the excluded. In addition, big national banks have recently moved away from the rural areas.

As a consequence, most people use informal financial services from pawnshops, moneylenders, friends and family and the like. Not only is the supply of such informal services limited, people who use them are also vulnerable to abuse and fraud.

The government is gravely concerned about lack of access to formal financial services. This situation not only limits its ability to implement economic and monetary policy, and implies risks for financial stability; continued high levels of exclusion also entail the danger of social unrest, and put into jeopardy the overarching goal of social harmony.

Since 2005, the government has been taking decisive action to make the system more accessible for all. It has decided to promote microfinance as a line of business in existing institutions (e.g. City Commercial Banks, Rural Credit Cooperatives, Postal Savings Bank of China), and as the main product of a set of new business models (e.g. MicroCredit Companies and Village & Township Banks).

In 2007 and 2008 it issued guidelines for the new business models, intended to ensure a balance between safety and effectiveness. Provincial governments were tasked to develop their own specific regulations, and public and private investors were invited to establish pilot institutions. After some years of experimentation, the national government is expected to develop country-wide legislation.

Rationale for the Working Group

The guidelines for China's new microfinance business models include a possibility for both local and foreign private investments.

For **private investors**, investing in these business models has advantages as well as disadvantages:

The main advantage of investing in China's enormous market is the potential for financial and social returns. In addition, significant learning can be derived on the delivery of financial services at scale. The government's experimental approach is bound to result in interesting innovative products and policies that may be replicable within China and that may inspire innovation in the rest of the world.

An important disadvantage of investing in these business models at this point in time is the fact that policies and regulations are restrictive in several ways, and there is no level playing field for the different types of institutions. Besides, policies and regulations are in a heavy state of flux, and it is difficult to know exactly in what direction they will develop. This increases the level of investor risk. For the **government**, bringing in private investors into these business models also has advantages as well as disadvantages:

Potential advantages include a wider, deeper source of funding, and also incentives for business-like behaviour and efficiency on the part of the microfinance institution receiving investment funds. In addition, foreign investors or investors from other provinces may bring technical knowledge and experience that would otherwise not be available.

Disadvantages may occur, however, when investors do not buy into the double bottom line of microfinance, or they do not care about the country's long-term goal of social harmony. Some investors may cause an institution to drift away from its mission to serve the previously excluded. Others may take action or push for policies that regulators consider to be against the interest of the country in the long-run.

WMFG believes that the government and investors, both foreign and local, have a common interest in ensuring that the advantages of private investment prevail. It is in everyone's interest that investors contribute positively to the development of a more market-oriented economy, and act responsibly when it comes to establishing and operating institutions targeted at making the system more inclusive. It is also in everyone's interest for the government to support positive investor behavior.

Open and regular fact-based communication between the government and investors is an effective way to achieve positive investor behavior and supportive government policies. For this reason, WMFG is creating a Working Group on Investment in Inclusive Finance in China.

Objectives

The objectives of the Working Group are:

- To promote inclusive finance in China
- To promote the mutual exchange of information and learning
- To promote responsible investor behavior
- To promote supportive government policies

Composition and functioning

The Working Group consists of 15-20 high-level decision makers selected on the basis of their reputation and experience in inclusive finance in China. WMFG recruits the members of the Working Group, and gets their commitment to contribute financial resources to cover the costs of its research and convening activities, and in-kind resources to enhance the quality of the group's work. Potential members include representatives of **international and Chinese**:

- Banks
- Investment funds
- Networks of providers of inclusive financial services
- Development finance institutions
- Donors and foundations

The Working Group convenes for **2-3 hour closed workshops** no more than **twice or three times a year**. At these workshops, the Working Group members:

- Exchange knowledge and experiences
- Decide on working group research topics and approaches
- Review new developments and research
- Decide on any immediate action they would like to take

After each Working Group meeting, WMFG organizes one or several **meetings of key working group members with relevant government representatives**. The purpose of these meetings is to present the outcomes of the research, and discuss any issues of concern. Government bodies include:

- State Council
- People's Bank of China
- China Banking Regulatory Commission
- Alliance of Provincial Finance Offices

Activities

1. Research

The group's principal activity is the commissioning of research that will help to achieve the objectives mentioned above. WMFG believes that research will not **only facilitate the exchange of knowledge and experience** among members, but also **provide a basis for discussion among investors, providers and regulators**.

Potential research topics may include, but are not limited to:

1. Analysis of the performance of different institutional models
2. Case studies of investments in inclusive finance in China
3. Comparative analysis of the approaches of different investors
4. Analysis of specific issues, e.g.
 - a. Microfinance and financial stability
 - b. Role of local versus international investors
 - c. Multiple investments by single investors
 - d. Wholesale debt / equity funds for MCCs, VTBs and NGO MFIs
 - e. Conversion of NGO MFIs into MCCs and MCCs into VTBs
 - f. Limitations on operations of MCCs and VTBs
 - g. Incentives for responsible investor behavior
 - h. Effective outreach to rural areas and the poor

WMFG assists the group in setting the research agenda, organizes the research team, oversees the research and executes quality control. It ensures publication of working group research in an attractive format, and targeted dissemination via electronic and physical channels.

2. Dissemination and media coverage

WMFG schedules the working group's closed workshops before or during major third party conferences that most of its members would like to attend. This facilitates the dissemination of the working group's research findings among an interested audience. It may offer members opportunities to give public presentations or participate in debates. This helps to get feedback from non-members, obtain buy-in for the research conclusions, and gather ideas for further research.

WMFG also provides the desired media coverage, by organizing press conferences and individual interviews for key working group members. Media coverage is expected to increase the working group's standing and influence.

3. Knowledge management and exchange

WMFG populates, maintains and manages an exclusive intranet for members, linked to WMFG's website. This **closed internet site** contains:

- Library with public studies and articles on inclusive finance in China
- Latest policies, rules and regulations
- Case studies and contacts of working group members
- Public and confidential working group publications
- Updates on ongoing working group research
- Detailed data made available by in-kind members
- Calendar of relevant events
- Links to other relevant websites

Linked to this platform, WMFG offers selected platforms for structured and as well as informal virtual networking among working group members.