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INCLUSIVE · HEALTHY · RESPONSIBLE FINANCE

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THE REPORT OF FINANCIAL INCLUSION DEVELOPMENT IN CHINA (2019)

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Preface

In recent years，there has been a popular stating that“Important Thing Needs to be Said Thrice.”What is that important thing in inclusive finance?

It is right there in the name：Inclusion，Inclusion，Inclusion.

It is important to emphasize that inclusive finance needs to live up to its name. Its purpose is to include the enterprises and people who have been excluded from the traditional financial system. Eventually，through providing financial services to them，it will form an inclusive finance ecosystem.

Which enterprises and people have been excluded or inadequately served by the traditional financial system? As we know，they are the micro，small and medium-sized enterprises（MSMEs）and disadvantaged individuals. There are many reasons for the exclusion or lack of services in the traditional financial system，such as information asymmetry，high cost，and lack of financial literacy，etc.. When the financial system，including traditional financial institutions and new financial service providers，began to include those previously excluded，many old and new problems started to appear，hampering the effectiveness of financial inclusion and leading to more confusion.

At the core，there are two major differences between inclusive finance and traditional finance. The first difference lies in the target audiences. As main the target audience for inclusive finance，MSMEs and the disadvantaged individuals have unique characteristics and their behaviors depend largely on their perceptions of financial health. The second difference lies in the service models of financial institutions. Due to the unique characteristics of these customers，financial inclusion requires financial service providers to adjust their service methods accordingly. It is necessary to provide financial services in a responsible manner with a focus on

customer protection.

Financial health is a relatively new concept. We interpret it as the personal financial status of consumers based on their level of financial literacy，their use of financial tools，and as a result of their financial actions.

Just like people's health status can be classified as healthy，sub-healthy，and sick，so is their financial status. The concept of health has been introduced into the financial sector internationally to describe the financial situation as a result of consumers' access to financial services. This includes consumers' understanding and mastery of financial knowledges，and it involves financial education and financial literacy. According to our research conducted in rural areas，rural residents usually score low on the financial health indicators，which is also an important reason why rural finance is difficult to be carried out and farmers are less willing to accept credit and insurance services. The concept of Financial health can guide consumers to enjoy financial services while avoiding potential risks. People should regularly observe and monitor their financial health status caused by their use of financial services，just like monitoring their health conditions. We know that consuming a large amount of junk food could lead to high blood pressure and high blood sugar level. In financial services，over-allocation of risky assets or excessive debt by consumers is also unhealthy and has negative economic consequences.

Financial health is a concept from the perspective of financial consumers while the concept of responsible finance is mainly viewed from the perspective of financial service providers. Since inclusive financial service providers serve people with low financial literacy levels，they should adopt a responsible attitude，take customer protection as the fundamental principle，and provide services with a customer-centric design. This will ensure that the inclusive financial business achieves the double bottom-lines of commercial value and social value.

Customer protection is a very important part of inclusive finance. Just like the development of China's capital market since over 20 years ago when investor protection mechanism prevented retail investors from losing large amount of money caused by market manipulation. It could be said that an investor protection mechanism is a necessity for the capital market. Similarly，in this new era of inclusive finance，customer protection is also a necessity for the existence of inclusive finance. Without effective customer protection mechanisms，there will be no healthy inclusive finance.

Regulatory agencies pay special attention to financial consumer protection, just like how the capital market has focused on investor protection. In capital market, there are institutional arrangements for classifying qualified investors, emphasizing transparency, openness, impartiality, and fairness in information disclosure. The big question now is that what should be emphasized in the inclusive finance system?

Some academic studies have shown that people with lower incomes are more likely to take risks and display unhealthy financial tendency. When serving these people, service providers should treat them in a responsible manner. This should be one of the characteristics of financial inclusion.

Another important issue in the construction of inclusive finance is how to channel social capitals into the inclusive finance business. Inclusive finance could grow effectively only when social capitals actively flow into inclusive financial service providers who serve the role of intermediaries. Here we need to consider the role of capital market. Securitization is undoubtedly a good way to raise capital. Establishing a secondary market for microfinance among financial institutions would also be a good idea to explore. There are already some practices in the market, but the government needs to create policy to ensure proper practice.

In the past few years of implementation, we have realized that inclusive finance is more than just providing credit and other types of financial services to MSMEs and the disadvantaged individuals. Solving the problem of costly and difficult financing should be the outcome of building an inclusive finance ecosystem. We realized that this goal of building an inclusive finance ecosystem is more important when considering its long-term benefits. Just as people get diabetes, they could just take hypoglycemic drugs without changing their lifestyles. But then it only accounts for the symptom but not the disease itself. In the process of promoting the development of inclusive finance throughout the nation, the goal should be the establishment of an inclusive finance ecosystem as an ultimate cure to the imbalanced growth and development.

Inclusive finance in its essence is the improvement of the MSMEs and disadvantaged individuals in terms of survivability, development, and even creativity. In this sense, in the process of building inclusive finance, we place special emphasis on financial education, financial literacy and financial capabilities. Each inclusive financial services provider should have the ability of customer education

while providing financial services and products. Everyone knows the difference between "giving a man fish" versus "teaching a man how to fish". This is the essence of a responsible financial system.

The financial inclusion practices in the past few years have given us many insights. The one impressed me most is that, the normative development of inclusive finance depends not only on the supervision of the regulatory agencies and the improvement of laws and regulations, but also on the self-regulation of the entire industry. As proponents and observers of inclusive finance, we expect the practitioners to be truly self-regulated, customer-centric, and responsible in their business. The harmonious development of society depends on the perfect combination of law and morality. Similarly, in the process of promoting inclusive finance, the close integration between supervision and self-discipline is also the basic prerequisite for the healthy development of the entire industry.

We have entered the fourth year since the announcement of the *Plan for Advancing Inclusive Finance Development (2016—2020)*. As observers of the implementation process, we saw many lessons and experiences. We realize that inclusive finance is easier said than done. There will be new obstacles following every step we take. For example, when we encourage data-based financial technology, it is found that the issue of privacy protection has become very crucial and even digitalization itself has brought about the problem of digital gap. It could be seen that realizing inclusive finance will not be a race but a marathon that requires endurance, technical skills, and market mechanisms. It took China nearly 20 years to establish a modern banking system and it took almost 20 years to establish a capital market system. At present, this inclusive financial system is still in its preliminary stage and needs to be continuously improved. Based on previous experience, we expect that it will take at least another 20 years to establish an inclusive finance ecosystem in China. In this sense, this will be a long but worthwhile journey.

If the establishment of a modern banking system and the establishment of a capital market are considered to be the first two stages in China's financial development process, then China has now officially entered into the third stage-the establishment of an inclusive finance ecosystem. Based on discussions from countless conferences, it could be seen that inclusive finance has presently become the hottest topic, just like how they discussed the establishment of capital markets more than 20

years ago. As scholars, we must be calm during the discussion fervor. Fortunately, we have the experiences and lessons of financial development for nearly forty years in the past. This time, we could learn from past lessons and avoid the same pitfalls.

As the Chinese Academy of Financial Inclusion (CAFI) enters its fifth year, we are thrilled to see that our influences are expanding across different fields, industries, agencies, and societies both nationally and internationally. Report 2019 was completely written independently by our own in-house research team and the quality has improved significantly. This is a small but noteworthy milestone in our development. Here, I would like to express my sincere admiration to Dr. Mo Xiugen, who presided over this work, and all the colleagues he led. We also take this opportunity to express our sincere gratitude to our long-term strategic partners, our sponsors, and other cooperative organizations.

Bei Duoguang
Written in Xuanwumen, Beijing
20th July, 2019

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Summary

1. Overview of the Development of Inclusive Finance in China

After years of development, Chinese initiatives in inclusive finance have reached the forefront of the field. Currently, inclusive finance in China continues to grow with rapid pace. The government has been issuing many policies in support, the market has been constantly innovating and developing, and inclusive finance has been increasing in variety and form. But there are still challenges that need to be addressed.

The main measures taken by Chinese government in promoting the development of inclusive finance are as follows: First, on December 31, 2015, the State Department issued the *Plan for Advancing Inclusive Finance Development (2016—2020)*. This plan is divided into 8 sections: the general idea, institutional system with multi-faceted coverage, innovation in financial products and service means, acceleration in the construction of basic financial infrastructure, improvement in the regulations and laws regarding inclusive finance, guidance and stimulation through policies, enhancement in the education of inclusive finance and consumer rights protection, and organizational guarantees and implementations. These sections shed a guiding light on the future development of inclusive finance in China. Second, in May 2017, the China Banking Regulatory Commission, along with eleven other departments, jointly issued the *Implementation Plan for the Establishment of Inclusive Financial Business Units for Large and Medium-sized Commercial Banks*. With an eye on real market circumstances, the plan requires commercial banks to set up an inclusive finance department within their organizational structure. By establishing a management system for business units that meet the needs of inclusive financial services, building a scientific governance mechanism and organizational structure,

improving the professional service system and the inclusive financial services capabilities, alleviating the problems of "costly and difficult financing" of microenterprises, "Three Rural Issues", entrepreneurial innovation, and poverty alleviation, and improving the availability, usage, and quality of financial services, the banks then could provide effective support for the real economy and prevent the tendency to the fictitious economy. Third, the government has formulated monetary and fiscal policies that are conducive to the development of inclusive finance. For example, in order to increase support for microenterprises and the "Three Rural Issues", the central bank has lowered the deposit reserve ratio of rural financial institutions such as the rural credit cooperatives and rural banks. The Ministry of Finance will exempt the VAT on the interest income of microenterprise loans of financial institutions. Fourth, the government will make clear the requirements to the banks regarding the development of inclusive finance. On April 25, 2019, Liu Guoqiang, deputy governor of the People's Bank of China, laid out a goal of an increase of 30% in microenterprise loans from the five state-owned large commercial banks in 2019 and a reduction of 1% in microenterprise credit financing cost. Fifth, the government will strengthen the supervision on new forms of inclusive finance. On April 10, 2017, the website of the China Banking Regulatory Commission officially issued the *Guiding Opinions of the China Banking Regulatory Commission on Banking Risk Prevention and Control*, which clarified that the focus of P2P reforms will be on the campus loans and cash loans.

There exist several changes in inclusive finance when the market is continuously developing: First, financial institutions vary significantly. Among them, the growth of microfinance institutions tends to be stable. From 2008 to 2015, the number of microfinance institutions increased rapidly, reaching a peak of 8910 at the end of 2015 before heading in a downward trend to 8133 by the end of 2018. P2P platforms experienced several major ups and downs. They surged to 6430 in the 2007—2018 period. But the number of foreclosed and problematic platforms reached 5409 and the number of normally operating platforms was only 1021, which was 1219 fewer than the number at end of 2017. By the end of June 2019, the number of normal operating platforms in the P2P online lending industry has dropped to only 864. The Internet microfinance industry developed in a regulated manner. In 2010—2018, there were more than 280 Internet microfinance companies in the country, of which 93 were with registered capital of more than 500 million yuan (inclusive). After the suspension of establishing new Internet small loans companies, a unified management process will be created to oversee these 280 Internet Microfinances Institutions. The

role of Internet private banking is becoming prominent. WeBank and Mybank have become the vanguard of inclusive finance. Second, there are continuous innovation in inclusive finance business model. More and more fintech companies are partnering up with financial institutions in exploring co-lending and agency lending programs. Third, fintech companies have empowered traditional financial institutions by helping and solving the problems of low efficiency and high costs in the traditional financial industry.

During the developing process of inclusive finance, several interesting issues arose: First, there is the potential risk of "Mission Drifting" in financial institutions. Rural credit cooperatives are the main participants of China's inclusive finance. In recent years, some rural credit cooperatives have experienced commercial reforms and became rural commercial banks. Some of these rural commercial banks have been listed on the capital market. After the listing, conflict might exist between the shareholders' desire for profitability and the government's requirement for the development of inclusive finance and it remains to be seen whether this will be a major problem with the initial objective of serving the "Three Rural Issues" . Second, the relationship between the public good property of the credit referencing system and commercialization remains unclear. On one hand, the public credit referenceing system of the central bank currently has record of less than 30% of the total population. On the other hand, the private companies have created their own credit referencing system from the accumulation of a large amount credit information from commercial activities. For example, Zhima Credit has accumulated a large amount of credit data through digital technology. The credit information system has always been regarded as a public good. But now the private sector wants to seek commercial value from the system. Further observations need to be made regarding the competing and complementary nature of the credit referencing systems. Therefore, focus need to be placed on the management and regulation of the credit information system. Third, financial institutions may face pressure when achieving financial sustainability under certain policy requirements. In order to support the development of inclusive finance, the government has imposed interest rate ceiling on relevant loans of financial institutions, but the institutions lack rooms to ensure the profitability and sustainability of inclusive financial activities. Further follow-ups are needed to see whether profitability can be sustained. Fourth, there exists a trade-off between financial innovation and compliance. The innovation of business models such as co-lending and agency lending has brought new vitality to the development of inclusive finance. However, due to the lag of supervision, it is impossible to supervise the compliance for the new business model, which could lead

on unsupervised financial risk and not conducive to the healthy development of inclusive finance. Fifth, the situation of financial health and consumer protection under the conditions of digital finance has become a complicated issue that must be addressed in the development of inclusive finance. With the development of financial technology, the problem of consumer privacy has become more severe, which has greatly increased the probability of financial disputes. It is important to consider how to prevent consumer privacy information from leaking and reducing the occurrence of financial disputes. In addition, the government, financial institutions, and society must ensure that financial services do not lead to financial ruin for the consumers. Sixth, it is important to clarify the responsibility of financial institutions. Financial institutions are relatively more powerful relative to consumers when providing financial service due to their expertise on product details and risks. So, by increasing the transparency, fairness and inclusiveness of services, the financial institutions could improve the social benefits of financial services.

In response to the latest development and problems mentioned above, the research team of Chinese Academy of Financial Inclusion (CAFI) has conducted field research, key interviews and internal meetings, and decided to interpret the *Report of Financial Inclusion Development in China (2019)* from prospective of Inclusion, Health and Responsibility. The report will also discuss the relationship between financial inclusion and social development. According to the research topics, the report conducts empirical and normative analysis using surveys, case studies, and literature review. The data for the empirical analysis mainly comes from the following: First, works and paper published by the National Bureau of Statistics, the People's Bank of China, the China Banking Regulatory Commission, and various levels of central and local government. Second, the survey data o f households and microenterprises from surveys conducted by CAFI in Zhejiang, Gansu and Beijing. Third, the survey data from the national small loan companies survey conducted by CAFI.

2. Inclusive Finance

In previous reports, we discussed inclusive finance with the themes of "Good Finance, Good Society" "National Development Strategy of Financial Inclusion" "Capacity Building in Financial Inclusion" and "Conquering the Last Mile" respectively. This report follows in a similar vein and continues to analyze the role of regulation, digital technology and traditional banks in the development of inclusive finance.

More importantly, this is the first time that the report will discuss the relationship between inclusive finance and macroeconomic development.

Inclusive finance has goals on the macro level and concrete results shown at the micro level. The development of inclusive finance will not only bring the excluded societal members back into the financial system at the micro level, but also promote economic growth on the macro level (Chapter 1). As a concept, inclusive finance has a natural connection with inclusive growth. Both alleviate the gap between the rich and the poor by increasing the inclusivity of small and medium-sized enterprises and vulnerable groups. Since financial exclusion is also an important part of social exclusion, the development of inclusive finance and the reduction in financial exclusion are also important ways to achieve economically inclusive growth. From the micro perspective, inclusive finance can improve the welfare of family life and increase households' economic income. From a macro perspective, inclusive finance could accelerate circulation of goods, improve economic efficiency, create economic stability, construct a social credit system, improve government efficiency, and increase employment. Therefore, it is necessary to take measures to promote the development of inclusive finance in order to further promote inclusive growth. We should strengthen the construction of data infrastructure and integrate data resources dispersed in different institutions and departments, strengthen the construction of the digital credit system and promote the development of social integrity, establish a digital regulatory system to ensure economic stability and security, and strengthen financial capacity building and improve the production efficiency of vulnerable groups. At the same time, it is important to emphasize the role of the government in developing inclusive finance and promoting inclusive growth. The amount of effort and coordination required for such a task means that the government must play a vital role in the development of inclusive finance.

The macro results of inclusive finance need to be supported by specific measures at the micro level. Improvements in the inclusiveness of financial services will require the widespread implementation of new digital technologies, inclusive regulation, and the strategic transformation of financial institutions.

The application of digital technology can reduce costs in financial services, greatly increase the reach of financial services, and enhance the inclusiveness of financial services (Chapter 2). In terms of improving financial inclusiveness, the significant roles of digital technologies are: First, technologies lowers operating costs, risk management costs and transaction costs. Second, through improving the efficiency of risk identification and risk resolution efficiency and providing risk

diversifying products，technologies improve risk control effectiveness. Third，technologies promote a healthy growth of competitive supply by providing personalized and multi-faceted financial products and combining the advantages of traditional finance and digital finance. It is worth noting that digital finance has its limitations. Though small，cost and capability required for the digital financial services are still limiting its further reach. Digital gap limits the ability of technologies from providing service to everyone.

Inclusive finance requires inclusive supervision to provide an effective regulatory environment（Chapter 3）. Inclusive supervision has three pillars. The first pillar is flexible regulation. Due to the complexity of the online financial market，one could not simply identify all market behaviors that do not comply with the current regulations as financial crimes. The second pillar is moderate supervision. While maintaining a red line of systemic risks，one should leave room for the development of Internet finance and supervise under the premise of ensuring consumers' fund security，information security and personal security. The third pillar is differentiated supervision. Regulators should accept the diversity of the financial environment，participating entities business methods，regulatory objectives，and regulatory measures and treat different businesses and entities accordingly. China's current regulatory environment puts inclusive financial practitioners and Internet financial platform in a compromising position. The ambiguous regulatory policy may lead inclusive finance into legal danger. The ambiguous legal system will hand down penalty upon inclusive financial platforms. Practitioners of inclusive finance might even face criminal convictions. In order to prevent the legal risks of inclusive financial practitioners and Internet financial platforms，we should build a comprehensive legal system concerning inclusive finance. First，we need to form a comprehensive legal system，speed up the formulation of rules and regulations regarding inclusive finance，and coordinate laws and regulations regarding traditional finance and Internet finance. Definition for new crimes should be added under the structure of established law to combat the inundation of new types of Internet crime. Second，we need to establish risk prevention and monitoring mechanism. This could lower risk and follow the trends in illegal financial crimes involved with inclusive finance，thereby nipping the problem in the bud. Third，it is important to increase inter-departmental collaboration and establish information filtering and sharing mechanisms. Finally，it is important to establish legal aid，introduce risk prevention and control mechanisms，transform the attitude from passive remediation to active prevention. One realistic step in that attitude transformation could be entrance restriction in Internet finance to reduce risk.

As the “mother of all industry”, traditional banks should improve their wiliness and ability to provide inclusive finance services to promote economic inclusive growth (Chapter 4). Inclusive finance has “double bottom-line”: social impact and financial sustainability. The latter is the foundation of the former. Presently, banks face a series of difficulties while providing inclusive financial services. With the continuing development of interest rate liberalization, new types of institutions are entering into the financial services market stimulating competition. As of a result, traditional banks’ total return on assets, return on net assets, net profit spread and other profit indicators are declining year by year. In this context, implementing inclusive financial strategy and expanding new customer groups are potential solutions for improved profitability. It is found that as important target clients of inclusive finance, microenterprises and micro economic entities have huge unmet demand in bank financing. Such a demand gap can bring potential profits, so banks are willing to provide more services. To enhance banks’ capabilities, banks can use digital technology to find the demand characteristics of the micro economic entities, provide customer-centric products, and build an integrated financial service ecosystem. Banks can also strengthen cooperation with other institutions, gain access to a wider customer base, improve profitability, and successful complete its transition to the inclusive finance model. We recommend increasing the interest rate at a suitable and flexible amount to increase capital market supply, building a multi-level market system in order to promote complementarity and cooperation between institutions, creating a credit and legal infrastructure, and implementing financial subsidies focused on technological investment capacity building of SMEs.

3. Financial Health

In the early stages of inclusive finance, people focused on how to solve the problem of availability and usage of financial services. Due to the inherent risk within finance, the use of financial services could lead to positive and negative effects. The content of inclusive finance should go beyond the use of services, to the achievement of satisfying results. Especially when inclusive finance is developing rapidly in China, people should value financial health as one of the key focus points. In this part, we introduce the concept of financial health and discuss the relationship between some businesses that are considered to be potentially risky, including “P2P” and “cash loans”, and their relationship with financial health.

Financial services that aligns with inclusive development will produce beneficial

outcomes in financial health（Chapter 5）. Financial health refers to the personal financial status that consumers can achieve through financial knowledge，use of financial instruments，and reasonable financial behavior. The objective aspects of financial health measure consumers' cash flow，assets，loans，and insurance. The aspect of cash flow measures whether the consumers have a stable and reasonable income and expenditure structure；the aspect of assets measures whether the consumers have sufficient emergency funds and fixed assets；the aspect of loans measures whether consumers have a reasonable debt structure and available loan channels；the aspect of insurance measures whether consumers have adequate and appropriate insurance. Subjective measures include consumer satisfaction with the consumer's current and future financial conditions. When analyzing the financial health level of Chinese consumers in a survey by CAFI，we discovered that the average financial health score of respondents was 67.79 points. From the five indicators of financial health，the highest scores are in the categories of revenue and expenditure indicators and subjective indicators，indicating that Chinese consumers pay more attention to the balance and sustainability of their income and expenditure，and are generally satisfied with their financial situation. The average scores of other indicators are between 65.2～68.5. Further research on the factors affecting the financial health of Chinese residents indicats：Personal income and expenditure of the consumer has a positive correlation with financial health. The amount of real estate assets and financial assets are also positively correlated with financial health. Age of the consumer also has a significantly positive coefficient. Female consumers on average have lower financial health than male consumers. Better physical health is associated with higher financial health score. Married consumers on average have higher financial health than unmarried/divorced consumers. The financial health of rural consumers is significantly lower than that of urban ones. Compared with financial knowledge，financial behavior has a more significant effect on the improvement of the consumers' personal financial health.

Some financial consumers' unhealthy financial investment may trigger risks in the P2P industry（Chapter 6）. Here are some findings on P2P borrowers：The average borrowing period of the P2P industry has been increasing year by year. The total number of borrowers reached a peak in November 2017，and then declined with the collapse of several P2P platforms in 2018. Demand is much higher for male borrowers than for female borrowers. Borrowers are mainly between 22 to 38 years old. More than 50% of borrowers use their loans for living expenses. Most borrowers borrow from 0 to 3 P2P platforms. Findings on P2P lenders include：The number of

investors in P2P per month reached its peak in November 2017. After the outbreak of collapses in many P2P platforms in 2018, the number fell sharply. Lenders are choosing to lend to more reputable platforms. More than 55% of the lenders are male. The average age of the lenders is 37 years. The rate of college degree or above among the lender is over 82% and more than 70% of lenders have annual income lower than 100000 yuan (inclusive). Around 75% of the lenders choose P2P platform with a required rate of return of 8%～12%. The lenders prefer short-term financial products. P2P products are characterized by relatively high return, easy operation, low investment threshold, flexible investment period which increases the attractiveness of P2Plending. After the massive closures in 2018 and strict regulations, lenders have become more rational in choosing P2P platforms. However, there are still a large number of people who use P2P as their main financial investment product. Taking risks into consideration, we suggest that individuals should keep funds for pension, education, and basic living away from P2P investments. At the same time, it is necessary to further the capacity building of P2P lenders.

Cash loan enriches the financial supply system, improves the inclusiveness of the financial market, helps to enhance consumer financial health and is an important way of financing for low income individuals (Chapter 7). Cash loans have the characteristics of no scenarios, no requirement of proceeds usage verification, no borrower restriction, and no collateral. It is an important source of credit for long-tail consumers. Cash loans can help borrowers smooth cash flow, enable borrowers to recover from financial shocks, and seize opportunities for improvements. But financial consumers need to keep their debt and interest burdens within a manageable range, or they will face the problem of excessive debt. Cash loans have the function of improving the social credit system. The properly regulated development of the cash loan industry helps to suppress the "underground borrowing" and maintain social stability. At the same time, with the development of big data, cash loans also have the function of supplementing social credit information. Sudden tightening up of regulatory policies, lack of sufficient laws and regulations, and consumers' unhealthy lifestyles and lack of financial capacity led to the illegal "714" (7 days or 14 days ultra-short-term high-interest) loans with disastrous consequences for borrowers involved. However, due to relatively conservative consumption and borrowing habits of Chinese consumers, borrowers' sensitivity to changes in interest rates, we believe that properly regulated cash loans will not lead to wide-spread social problems. However, the financial ability of the general public in China, especially among the

long-tail consumers，is still weak. Financial service providers need to keep consumers' welfare in heart and be responsible in their business to keep customers away from overindebtedness.

4. Responsible Finance

The financial health of the consumers is on one hand related to the financial ability and behavior of the consumers and on the other related to services of the financial institutions. It is the responsibility of financial institutions to ensure that their financial services bring beneficial results to the consumers. Financial responsibility is based on transparency，fairness，and inclusiveness，and relies on the "Consumer Centricity" mentality.

Responsible finance is an important basis for consumers' financial health（Chapter 8）. Responsible finance means that financial institutions should provide financial services in a transparent and fair way. The pillars for promoting responsible financial development include industry codes of conduct，consumer protection laws and regulations and supervision，and improvements in consumer financial capabilities. In essence it is "Consumer Centricity" and "Consumer Protection" . In terms of industry self-regulation，the number of financial industry associations in China has increased in number and magnitude. Self-regulatory organizations such as the China Banking Association actively develop relevant industry self-regulatory rules to regulate the development of the industry in a responsible way. In terms of law，the *Law of the People's Republic of China on the Protection of Consumer Rights and Interests* and the *Law of the People's Republic of China on Commercial Banks* form the backbone. The *Measures for the Administration of the Protection of Financial Consumption Rights of the People's Bank of China*（*Trial*）and the *Implementation of the Protection of Financial Consumer Rights of the People's Bank of China Measures* are related policy provisions. The Financial Consumer Rights Protection Bureau of the People's Bank of China is the main body of supervision and responsible for financial consumer protection. In terms of consumer financial capacity building，in 2013，the People's Bank of China，the China Securities Regulatory Commission，the China Banking Regulatory Commission，and the China Insurance Regulatory Commission formulated the *National Strategy for China's Financial Education*. In the digital age，all parties need to jointly build a transparent，fair，and inclusive industry environment. First，it is important to advocate industry self-discipline，the Internet platform as a digital financial service provider should clearly understand the

importance of platform responsibility. The Internet platform assumes more financial responsibilities compared to traditional financial institutions. Second, given the advancement in Internet financing, regulators need to "balance" their ability in identifying and monitoring risks more effectively with their ability in accommodating legal compliant Internet finance innovations. Third, financial consumers need to learn about the Internet and digital finance with an open mind and improve their ability to manage their financial assets.

Financial consumer privacy protection and dispute resolution are especially important in a responsible financial system (Chapter 9). Digital technology in finance has greatly promoted the development of financial inclusion. But the spread of digital technology has also led to many breaches of private consumer information and even caused financial disputes which caused severe losses to consumers. Breaches in private data is mainly caused by improper data collection and usage. No matter the demographic of the consumer, the risk of data breach cannot be avoided. Consumers do not have the capacity to protect their private data. Therefore, that responsibility must be on the shoulder of financial services providers. Financial service providers have the oblitigation to inform, protect, manage, limit, and destroy user data. In order to better protect consumer privacy, protection technologies should be upgraded to the latest version. Internet companies should always upgrade and innovate privacy protection technologies based on the innovation and development of their industry in order to safeguard their consumers. At the same time, the government should establish a unified law, clarify the responsibilities of all parties in the process of consumer information protection, and supervise the development of industry norms. It is also necessary to encourage industry self-regulation, and it is recommended to set up an industry self-regulatory organization as a way to protect consumers. In order to better resolve financial disputes, financial institutions should prioritize their importance give internal dispute resolution departments higher authority. Perhaps the results of resolved financial dispute could be used in the institutions' evaluation. Another way to resolve financial dispute is to open a litigation channel, simplify its process, and lower the cost for the consumer in seeking litigation. Finally, it is important to enhance consumer education to increase their awareness of financial risks.

The nature of responsible finance is "Customer Centricity" (Chapter 10). First, in order to provide inclusive financial services, traditional financial institutions must change their existing service model and redesign their products and service system based on the needs of small and medium customers. Second, the development of

digital inclusive finance requires service providers to design products with customers at the center, with the intent to minimize the digital gap and focus on customers in terms of convenience, ease of use and security. Third, customer-centric product design emphasizes the importance of providing financial services according to the characteristics of customers. Finally, the groups served by inclusive financial service is fluid, which requires that the products that provide inclusive financial services to be adjusted accordingly. By adapting with clear definition and flexibility, the products could weather through highs and lows. Enterprises should design "Customer Centricity" products when conducting their business. The customer-centered product design principle is that the company should meet the customer's needs to the greatest extent possible. In addition, the company should consider the understanding, habits and other characteristics of consumers in order to develop products that meet user characteristics. To accomplish this customer-centric thinking in enterprises, the enterprises need to break the traditional isolated working culture but incorporate an inter-departmental cooperation model to provide complete and comprehensive service packages to consumers.

"Customer Centricity" requires fair pricing defined by market mechanism, and we believe fair pricing is the premise of long term development of financial inclusion (Chapter 11). Fairprices are mainly determined by the demands of customers and the supply capacity of financial institutions. Customers' demands determined by personal characteristics, financial behavior, and financial capabilities. Through the case analysis of Lishui County, Zhejiang Province, the personal characteristics, financial behavior, and financial capabilities of consumers have different degrees of impact on financial service needs. Without considering the specific characteristics of customer groups, it is easy to mischaracterize them, which in turn leads to unreasonable pricing. At the same time, it is also found that some factors that theoretically should affect consumers' interest rate ceiling, such as savings and wealth management practices, have virtually no significant impact. Therefore, financial institutions should conduct accurate analysis of the target demographic of their products, so as to better judge the needs of the consumers on financial services. The financial institutions' supply capacity should factor in the cost of capital, operating costs, and risk. Free market competition can play a role in promoting industrial optimization and automatically eliminate investment with low returns. When the government stipulates a price ceiling below the market equilibrium interest rate, some capital is allocated to less productive investment projects, resulting in inefficient resource allocation and deadweight losses. Deviation from the equilibrium price control will

lead to problems such as large unmet demands, excessive loans, and emergence of "underground" market, which violates the principles of inclusive finance.

5. Inclusive Finance and Social Development

The core of inclusive finance is the accessibility and usability of services. In addition, it is closely related to financial institutions' responsibilities, consumer financial health, and even macroeconomic growth and development. In practice, small and micro financial institutions are important participants in the development of inclusive finance. The core services provided by small and micro financial institutions are credit services, which small and micro enterprises could use to improve their production efficiency. Small and micro enterprises are the most important economic entities in rural China. The Chinese government has proposed a strategic plan for rural revitalization, in which inclusive finance can play an important role.

The development of rural industries is an important part of inclusive economic development and requires the support of inclusive financial services. At the same time, the level of financial health of rural micro-economics might have a positive impact on its financial capabilities (Chapter 12). Through the survey of enterprises in Beijing and its surrounding areas, we discovered that most small enterprises lack management skills and innovation ability, making financing difficult. Although there is constant improvement in the inclusive financial services by the newer rural financial institutions and there is a constant proliferation of digital technology which brings forth new opportunities of development, issues such as corporate cash flow management and accurate financial accounting still need to be improved. Financial institutions need to create more innovative financial products and improve their technological service to rural industry. According to our survey results, inclusive financial services can play a very important role in payment and financing. First, the inclusion of new institutions has increased inclusiveness. The new financial institutions have enriched the market structure, brought digitization of payment methods, diversified financing channels, and enhanced the inclusiveness of the financial system. Second, the widespread use of non-cash payments can reduce business costs and accumulate credit data. Presently, non-cash payment in rural areas is more prevalent than cash payment. On one hand, with the transformation of offline transactions and payments to online methods, costs could be saved. On the other hand, by accumulating transaction behaviors data such as online transactions,

financial institutions could gain data for the basis of credit for small and micro enterprises. Third, digital financial technology can partially alleviate the difficulty of financing. Starting with behavioral data, the new digital financial technology could identify and "pre-lease" potential customers with high predicted credit score, which largely solves the problem of financing customers due to lack of collaterals and guarantees. Finally, financing services could improve liquidity and help business expansion.

Based on our survey data, it is found that microfinance companies are playing a pioneering role in the development of inclusive finance (Chapter 13). The role of microfinance companies in economic development includes serving the disadvantaged, promoting the popularization and innovation of financial technology, stimulating private capital, and bringing liquidity to every nooks and crannies in society. Some effects are that livelihoods are maintained, risks stabilized, and private lending is brought under the system of supervision. Microfinance is a risky business. It is found that the liquidity risk of microfinance companies is fluctuating, the interest rate risk is moderate, the capital risk is relatively low, and the credit risk is polarizing. Geographic location and the quality of the employees are some of the key factors that influence microfinancing company risks. Here are some more findings: Credit loans are as safe as collateralized loans. Equal instalment payment helps repayment. The loan maturity offered affects the company's survival. Most microcredit companies offer interest rate in compliance, and small-value customers often have good credit. The "farming, forestry, animal husbandry and fishery" industries are also very creditworthy. And it is believed that online borrowing is the future. It is suggested that the government include microfinance companies in the inclusive financial service regulation system. Supervision should be carried out based on geographic terms with a unified central policy. A national monitoring network should be established to promote the usage of regulatory technologies. The government should also appropriately relax the restrictions on leverage, broaden financing channels, enrich financial product types, moderately regulate cash loans, further encourage interest rates liberalization, reduce loan prices through competition, regard information security and consumer protection as the founding principle of regulatory agencies, and strengthen the capacity building for microfinancing companies.

Inclusive finance could promote microenterprises to increase their credit and reduce their default risk (Chapter 14). Commonly used indicators could reflect the loanability of enterprises, but they cannot effectively reflect the loan demand of

microenterprises. In reality, the conversion rate of credit and actual loans is low. What is more alarming is that some indicators are actually positively correlated with default risk. Indicators such as interest rates that are commonly believed to be related to credit and credit demand are actually not significantly related to some credit and credit demand indicators. These findings might be limited to our sample. Digital credit evaluation provides an effective way to solve these problems. A multidimension profile creation, can create a credit evaluation that reflects both loanability and credit demand of enterprises. To solve the problem of insufficient funds for microenterprises, we came up with several proposals. First, it is crucial to cultivate a culture of integrity and credit. We should promote the importance of a social credit system for microenterprises, and guide microenterprises to take the initiative in educating their own credit awareness. Second, microenterprises should actively take charge in the construction of their own internal credit mechanisms. Third, microenterprise should make full use of financial technology. Building an open information sharing platform, strengthening multi-party cooperation, and converting various types of data into credit data all help to form correct risk portrait of small and micro enterprises. At the same time, we should establish a proper credit service indicator system. A comprehensive credit indicator system should be constructed based on different enterprise size, management quality, industry, financial status, intangible assets, and other common factors. Fourth, we should establish proper credit enhancement program and guarantee service system to better assist the microenterprises. The government should establish special funds at the national and local levels, which could provide guarantees and credit enhancement services for microenterprises.