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Chinese FinTech ushering in Internet finance era in China

Takeshi Jingu

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Nomura Research Institute, Ltd.

Takeshi Jingu
Chief Researcher
Nomura Research Institute(Beijing), Ltd.

Executive Summary

Internet finance is set to revolutionize finance in China. While FinTech tends to be associated with the US and Europe, FinTech developments in China also bear watching.

Internet finance to play a key role in China's New Normal economy

Internet finance is set to revolutionize finance in China. The Japanese media tend to emphasize Chinese Internet finance's risks given its connection with shadow banking, but the Internet's role in Chinese finance going forward cannot be underestimated.

In March 2015, China announced a national "Internet Plus" policy in the National People's Congress's Report on the Work of the Government. With China aiming to break free of its existing economic growth model dependent on fixed asset investment, Internet Plus was presented as a new economic model. According to the Chinese government, Internet Plus will drive broad-based economic development powered by the Internet as infrastructure and an implementation tool instrumental in aggregating factors of production, optimizing their deployment and deeply integrating the fruits of Internet innovation into many economic and societal domains (Exhibit 1).

Specifically, China aims to "integrate the mobile Internet, cloud computing, Big Data, and the Internet of Things with modern manufacturing, to encourage the healthy development of e-commerce, industrial networks, and Internet banking" (Report on the Work of the Government)[1].

NOTE
1) The report also said, "We will press ahead with the nationwide project to deliver telecoms, radio, television, and Internet service over a single broadband connection, accelerate the development of fiber-optic networks, significantly increase broadband speeds, [and] develop logistics and express delivery services." Infrastructure development is thus also in the works.

Exhibit 1. Internet Plus Action Plan

Internet Plus is a new economic model.
Internet Plus will drive broad-based economic development powered by the Internet as infrastructure and an implementation tool instrumental in aggregating factors of production, optimizing their deployment and deeply integrating the fruits of Internet innovation into many economic and societal domains.
China will integrate next-generation information technology such as cloud computing, Big Data and the Internet of Things with modern manufacturing and production service industries, promote innovation, develop new business models, create new industry growth hubs, foster an environment in which anyone can participate in innovation and entrepreneurship, support development of smart industries, strengthen new economic growth engines, and upgrade the quality and efficiency of the national economy.
China has already established a CNY40bn venture capital fund for emerging industries.

Source: NRI (Beijing) based on Chinese government documents

Additionally, the Report on the Work of the Government unveiled a new manufacturing strategy named "Made in China 2025," similar to Germany's Industry 4.0 plan. Its aim is coordinated development of manufacturing, logistics, commerce and finance through utilization of the Internet. If the Chinese economy's New Normal is distinguished by slower long-term economic growth and a transition to a new economic development model, Internet finance will clearly play a key role in the latter.

Moving to further develop supply-chain finance

In May 2015, China's State Council released an Opinion on Striving to Develop E-Commerce and Accelerating Cultivation of a New Economic Engine. Specific finance-related initiatives mentioned in the State Council's Opinion include the following.

First, initiatives to strengthen financial services for e-commerce include (1) government research on incentives to encourage Internet companies to list their shares on domestic stock exchanges, (2) support for development of various forms of lending services, including asset-backed lending (secured by, e.g., real estate or intangible assets), by commercial banks, pledged-inventory custodians and e-commerce companies, (3) encouragement of development of supply-chain finance and factoring services by commercial banks, factoring companies and e-commerce companies and (4) stronger support for e-commerce companies from venture capital funds.

Second, initiatives to promote new financial-service tools include (1) building public service platforms to improve mobile financial services' security and (2) ensuring the safety and authenticatability of mobile e-commerce transactions.

Third, initiatives to develop a regulatory regime for new online financial services and products include (1) incentivizing online innovation by securities firms, insurers and public fund companies and building new regulatory models tailored to Internet finance activities and (2) regulating development of e-commerce platforms by insurers and researching policy-making on e-commerce-related credit guarantee insurance (for individuals, microenterprises and small businesses).

As these examples suggest, online financial services are diverse. They include mobile payments and settlement, cash management and insurance product sales and lending[2]. In the context of Internet Plus, however, online supply-chain finance is likely to be a key focal point going forward. Supply-chain finance initiatives are also

2) For example, financial services offered by e-commerce giant Alibaba include AliPay (online payment platform), Yu'E Bao (cash management) and AliFinance (online lending)

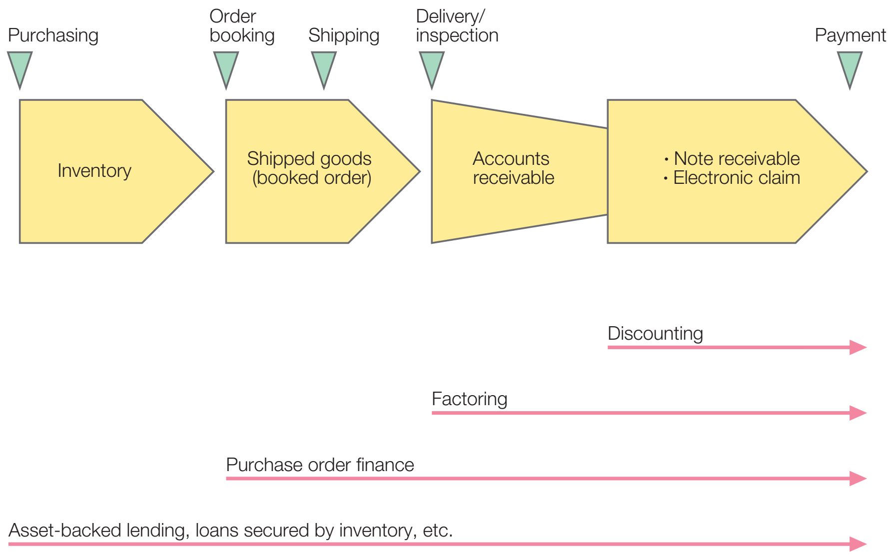
significant in terms of providing access to funding to SMEs, a big shortcoming in China's financial sector.

Even in China, supply-chain finance dates back more than a decade as a solution to challenges such as SMEs' shortage of collateralizable assets. One prominent supply-chain finance model is the so-called 1+N model, where a supply chain's core company's credit is used to obtain financing for the core company's upstream suppliers and downstream distributors and customers (the 1 represents the core company and the N represents the upstream and downstream companies). However, this model is underdeveloped in China, partly because some core companies do not want to deal with banks as trade creditors through batch factoring in place of the companies in their supply chains[3]. Some companies have consequently been pursuing asset-backed financing with a focus on distribution channels, but their efforts have been hindered by data collection and credit screening difficulties.

3) Because core companies have a bargaining power advantage over their individual suppliers, they are often overdue in paying their suppliers' invoices.

Against such a backdrop, credit extension based not on core companies' creditworthiness but data/information-dependent credit analysis will become increasingly feasible as electronic recordation of creditors' claims and interconnection of companies internal information system gain prevalence, supply-chain-constituent companies standardize their information processing through use of cloud computing, and utilization of Big Data technologies increases. Specific examples include financing based on risk analysis that utilizes Big Data, and account-receivable and inventory financing facilitated by data-sharing with logistics and warehousing companies (Exhibit 2).

Exhibit 2. Examples of supply-chain finance



Source: NRI (Beijing) based on Bank of Japan's Workshop Report on Supply-Chain Finance (February 2014)

Some commercial banks are already using these models. Other companies are starting to provide financing based on data analysis of small businesses' credit risk. While FinTech (Finance x Technology) tends to be associated with the US and Europe, FinTech developments in China also bear watching.

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Inquiries to : Financial IT Marketing Department
Nomura Research Institute, Ltd.
Marunouchi Kitaguchi Bldg.
1-6-5 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
E-mail : kyara@nri.co.jp

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