



# China Reinventing Microfinance

Economic development of outskirts and connected areas of Beijing

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# About ING

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## ING Profile

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- ING is a global financial institution of Dutch origin, offering banking, investments, a variety of life insurance, non-life insurance and retirement services.
- We serve more than 67 million private, corporate and institutional customers in over 40 countries in Europe, North America and Latin America, Asia and Australia
- In China, ING is active in Commercial Banking, Retail Banking (partnership with BoB), Insurance (ING BoB Life insurance) and Investment management (China Merchants Fund)

## ING Microfinance

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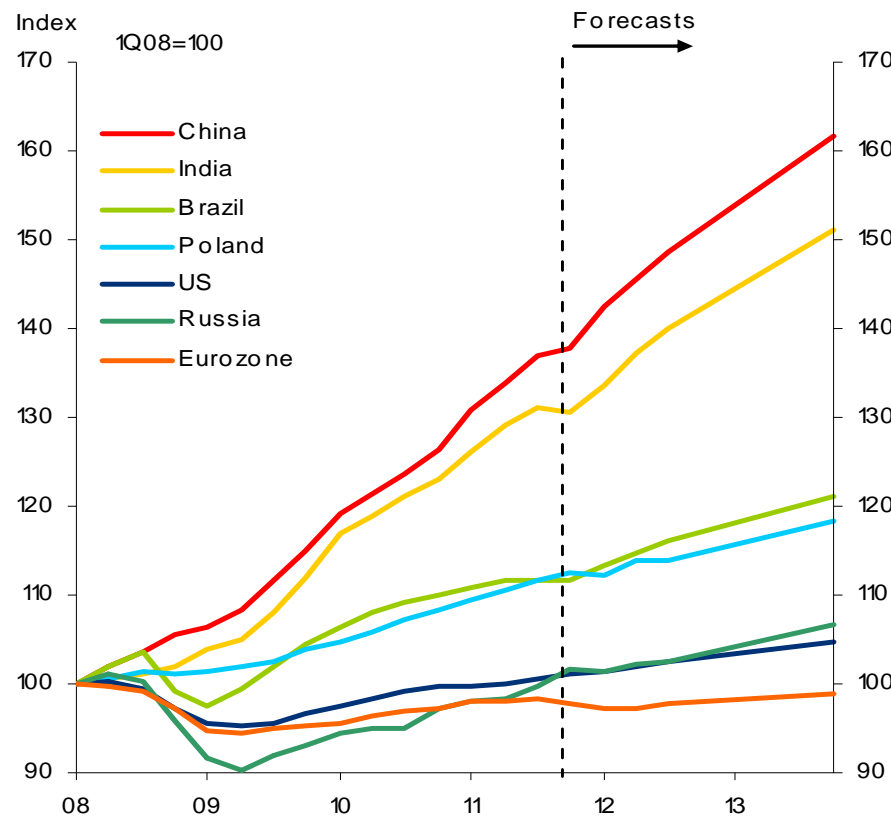
- ING entered the microfinance sector in 2004 with ING Microfinance Support and the first wholesale loans to Microfinance Institutions (MFIs) worldwide
- In India, ING Vysya Bank rural branches offers wholesale and retail services to the microfinance sector

# Global economic picture

- Economic development is a blessing for the poor

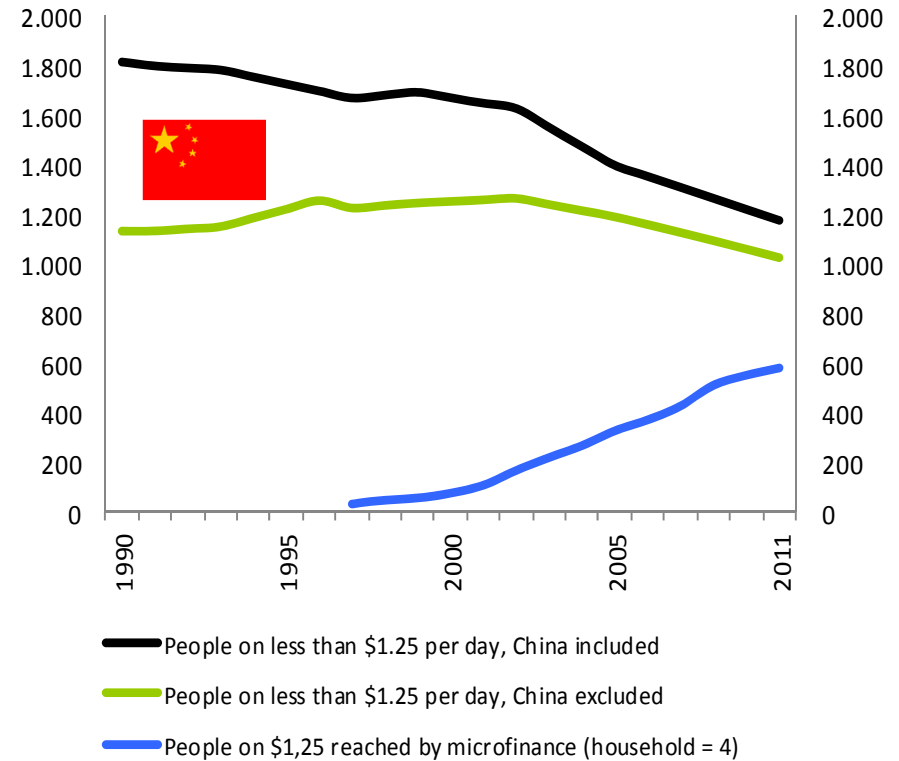
## Emerging world output surges ahead of developed world

(based on GDP)



## China lifted 400 mln people out of poverty

People reached by microfinance (millions)



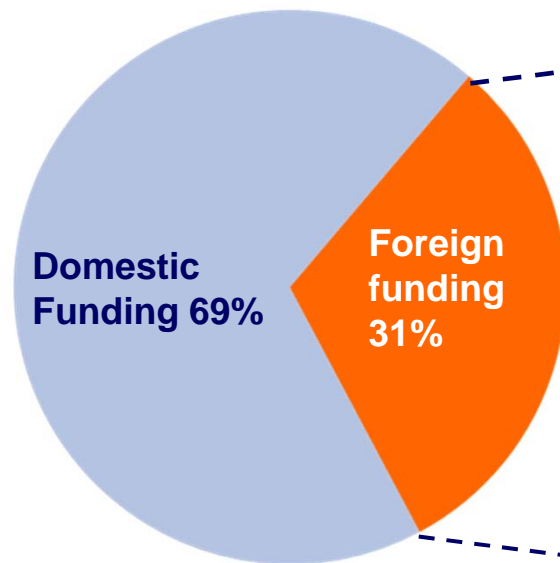
# Global Microfinance landscape

- Sources of funding

One third of worldwide microloans are from foreign investors

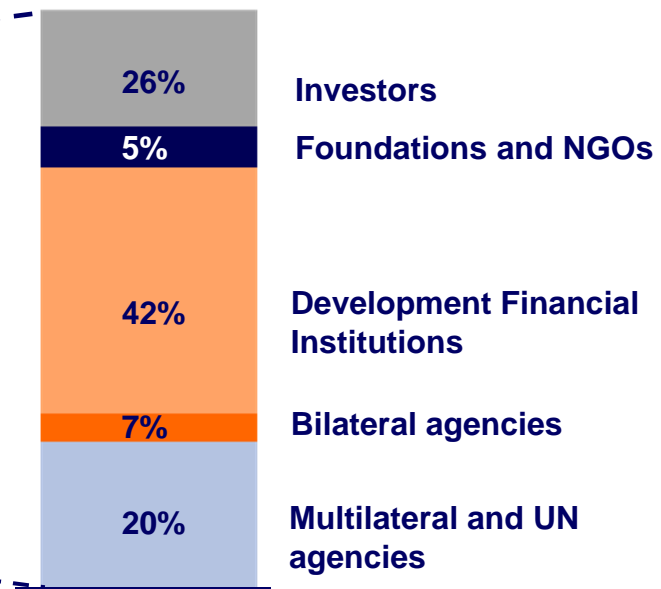
2010:

- Total demand for microloans EUR 250 bln
- Total investment EUR 60 bln



Of the EUR 20 bln provided by foreign funders, the Dutch account for 8.4%

Sources of Foreign funding



Source: ING Economics Department based on CGAP



# Global Microfinance landscape

- Main trends in the sector

## 1. Growth in direct lending to MFIs

- Global microfinance sector grew 43% per annum since 2005 despite financial crisis
- Funders continue to provide massive capital flows

## 2. Expansion of services provided to clients

- Broader product offerings (including insurance and savings) and services to improve living standards instead of poverty alleviation

## 3. Convergence of formal and informal banking sectors

- MFIs scaling up towards formal banking using advanced financial markets products like bonds, syndicated loans etc.

## 4. Adoption of new technology

- New technology enables new products reducing operating costs, such as mobile banking and digital fingerprinting

## 5. Increased need for transparency for all stakeholders

- Investors demand more transparency and implementation of client protection principles.
- This makes the sector more transparent both in operations and in pricing



# Microfinance in China

- Many opportunities ahead

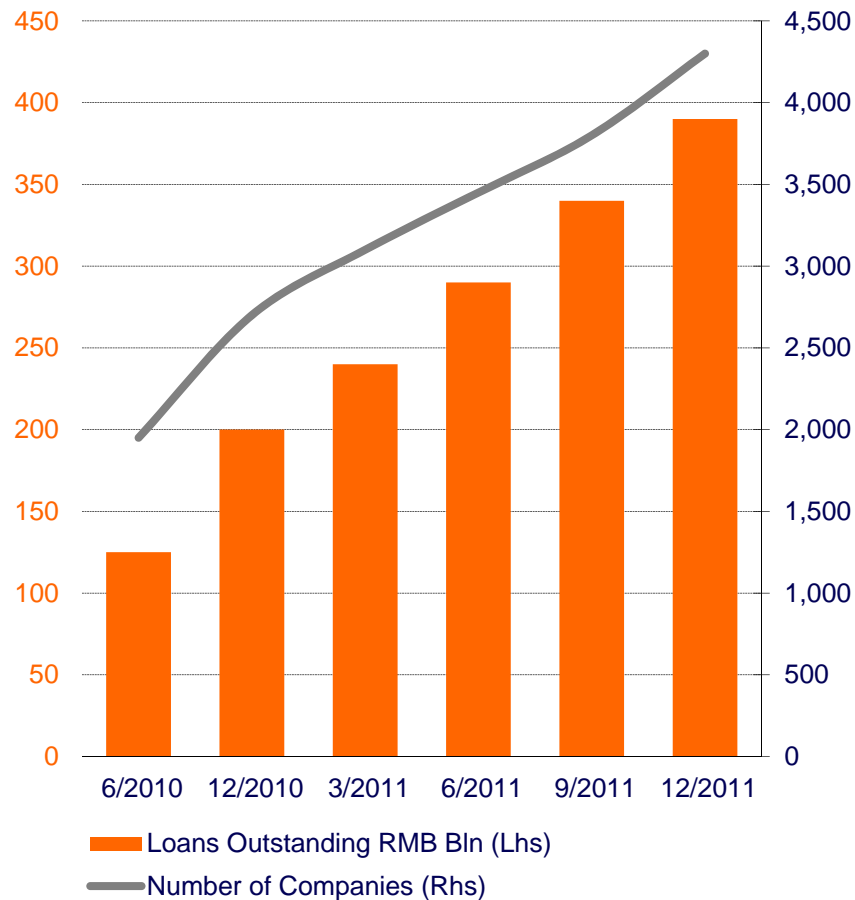
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- The legal entities servicing the lower end of the market are the Rural Credit Coops (RCCs), Micro Credit Companies (MCCs), Village and Township Banks (VTBs) and Small loan companies.
- The microfinance sector is under-developed in China compared to other countries in the region largely due to the limitations of regulatory requirements.
- Major banks pulled their rural offices out in the recent commercialisation and consolidation move due to higher costs of operation in rural areas compared to cities and towns.
- The government tried to encourage smaller loans to rural areas by creating VTBs. VTB licenses granted to international banks didn't result in new business. VTBs have remained in medium cities and made mostly property loans.
- In 2009, China Banking Regulatory Commission (CBRC) planned to establish 1,294 new type rural financial institutions (including 1,027 VTBs) within 3 years. By the end of Q1 2011 just 400 VTBs started business.

# Microfinance in China

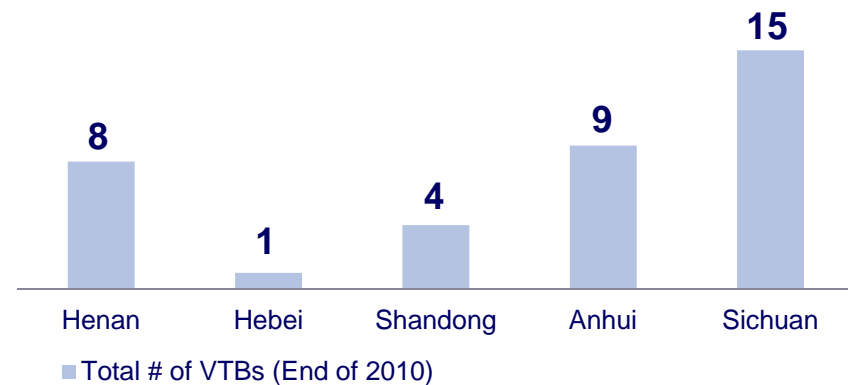
- Substantial growth of small loan companies

## Growth of small loan companies



- Between 2008 and 2011 the number of small loan companies increased seven fold. Over the past 18 months the industry progressed rapidly in terms of both loans outstanding and number of companies.
- VTBs have also grown, yet there are few in the top 5 provinces where the majority of Beijing migrants are coming from.

## VTBs in top 5 provinces where migrants originate

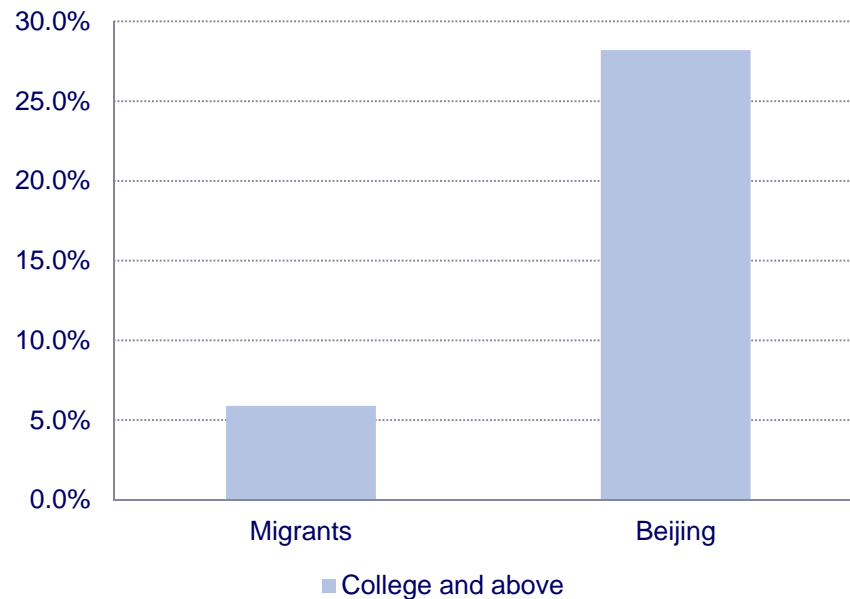


# Economic Development of Beijing

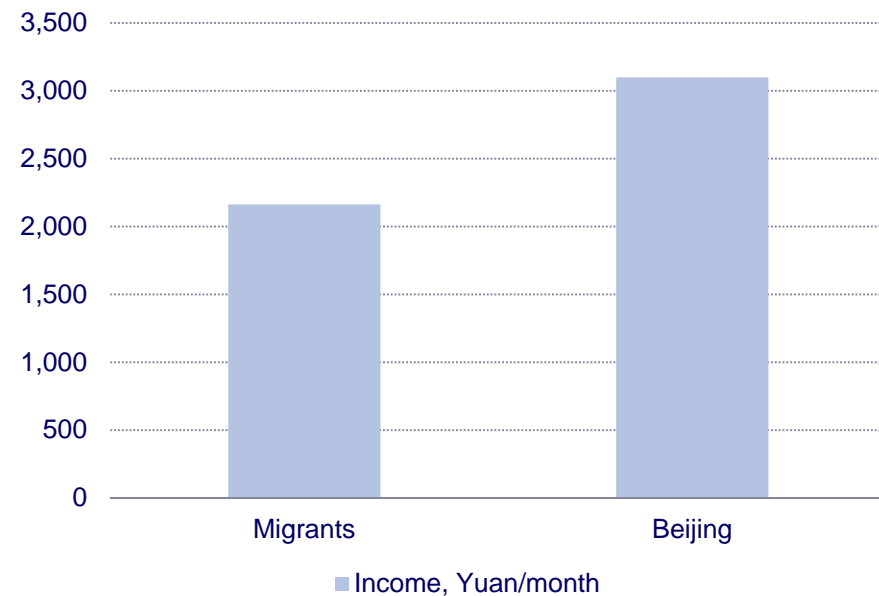
- Profile of targeted migrants in outskirts

- Beijing is the most rapidly urbanizing area in China and has a large amount of migrants from neighboring provinces. These migrants typically reside in the outskirts of Beijing.

## Educational attainment



## Income



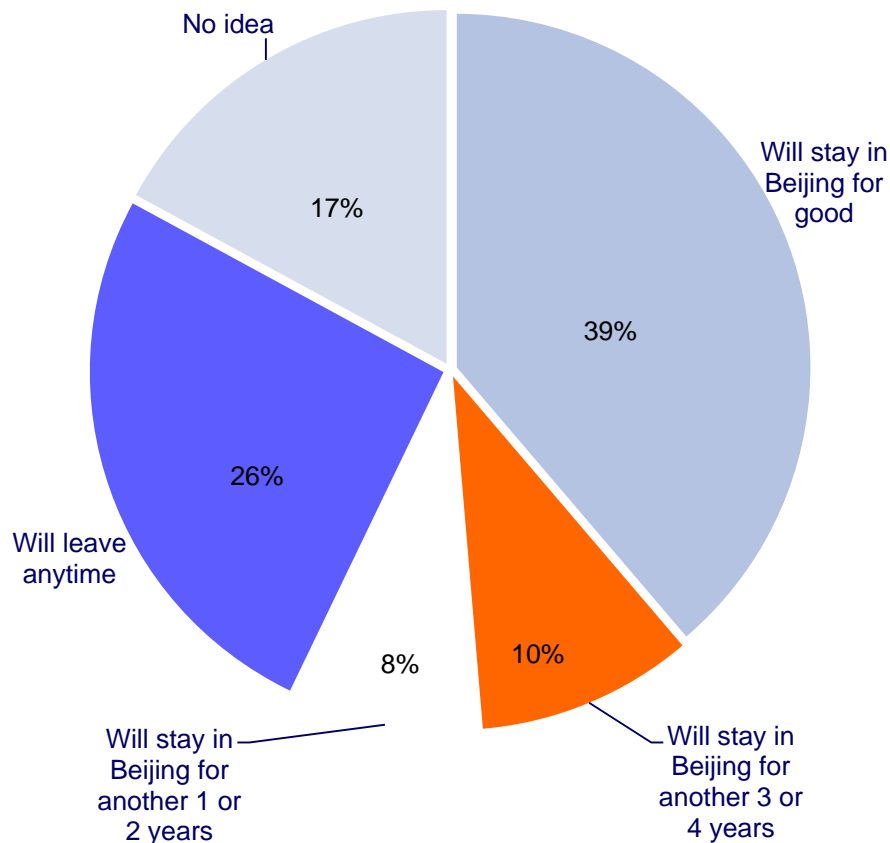
- Migrants lack educational attainment— only ~6% have at least college education compared to ~28% of Beijing’s population.
- The difference in income level between the permanent workforce (who dominate the tertiary sector) and migrants (mainly in the primary sector) has created an income gap.



# Economic Development of Beijing

- Focus on the right type of migrants

## Mindset towards Beijing (is it a home or a place to work)



- ~39% of migrants would like to remain permanently. Beijing needs the right type of permanent migrants, who are ideally ambitious, entrepreneurial and dedicated. This group is important for economic development and needs improved access to finance.
- Migrants of Beijing have to rely on the Micro, Small and Medium Enterprise (MSME) activities of the banking sector for their businesses. However, this segment is not targeted by commercial city banks mainly due to higher perceived risk, weak legal framework and higher costs related to loan size.
- Thus, most MSMEs rely on informal financing based on “reputation and relationship”. This poses as an extra hurdle for migrants who lack established friends & family networks.

# Reaching the target groups

- Small loan companies and VTBs as vehicles to penetrate the migrant MSME market

- Focus on self-employment activities of migrants in Beijing because of increasing demand for financial services.
- Government initiatives promoting small loan companies are ideal to reach migrant businesses.
- Small loan companies continued to grow despite last year's private lending crisis which reflects intense demand in MSME market.
- Transforming Small loan companies into village banks might be a good step forward in increasing transparency and reducing fraud.
- VTBs meet the diversified financial needs in rural areas as they mitigate rural fund outflow, fill in rural financial gaps and promote healthy competition in rural financial markets.

## Small loan companies

- Funding sources: Shareholder, bank loans and donations.
- Loan amount <RMB 2 million
- Short tenor - 70% of loans are for 3-6 months, while 30% are >a year.
- Prohibited by law to accept deposits from general public
- Capital from financial institutions max. 50%



## Village/Township banks (VTBs)

- Increased ability to extend credit with the ability to accept deposits
- However, reduces interest rate flexibility as they can only charge up to 2.5 times the benchmark rate (compared to 4 times for small loan companies)

# Potential challenges...

- Call for action for all stakeholders

Stakeholders	Challenges:	Call for action:
<b>The government</b>	<ul style="list-style-type: none"> <li>• Difficult requirements for VTB licenses</li> <li>• All VTB licenses are issued from Beijing and not at provincial level</li> <li>• Provinces with large amount of private equity restrict or even forbid individual investors from becoming shareholders of VTBs</li> </ul>	<ul style="list-style-type: none"> <li>• Government liberalization converting MCC licenses to VTB licenses</li> <li>• Provide incentives for commercial banks to do business in rural areas through policy changes such as lower business tax rates</li> <li>• Lowering threshold of access to public service system to improve VTBs payment and settlement system</li> <li>• Efforts to attract financial institutions to fund VTBs</li> <li>• Enhance communication and cooperation by establishing new local networks. Share technologies, information and policies</li> </ul>
<b>Big banks</b>	<ul style="list-style-type: none"> <li>• Not organized and equipped to service lower end of the market.</li> </ul>	<ul style="list-style-type: none"> <li>• Adopt innovative management models used by commercial banks in India (Yes Bank) and Peru (Mibanco)</li> <li>• Offer sustainable services to their clients like green- and social ethical investments funds to create good reputation</li> </ul>
<b>VTBs</b>	<ul style="list-style-type: none"> <li>• Small scale, weak capital strength, small number of outlets, and backward technologies</li> </ul>	<ul style="list-style-type: none"> <li>• Focus on social return instead of financial competition</li> <li>• Target the niche market - micro-enterprises, self-employed, farming households and migrant entrepreneurs</li> <li>• Meet demands of specific clientele through product innovation, efficient internal management and enhanced risk management by investing in IT systems</li> </ul>

# Proposed instruments to be deployed...

- Adopt successful global best practices

<b>1. Financing innovations based on collateral deficiency</b>	<b>Loans by order</b> <ul style="list-style-type: none"><li>• SMEs large amounts of contract orders needs funds to expand production</li><li>• Banks provide loans to SMEs based on prospective cash flows</li></ul> <b>Financial lease</b> <ul style="list-style-type: none"><li>• Banks pay for necessary but costly fixed asset (such as manufacturing equipment) and the SME has right to use the asset by installment.</li><li>• Asset ownership is transferred to the SME free of costs or at low price when installment expires</li></ul>
<b>2. Financing innovations based on moral hazards of SMEs</b>	<b>Collective loans</b> <ul style="list-style-type: none"><li>• Several SMEs apply for loans as a syndication, with an enterprise taking the lead and a guarantee center which acts as an intermediary</li><li>• The interest of SMEs are bonded together and they have shared responsibility in supervising each other. This minimizes non-repayment of loans</li></ul>
<b>3. Sector specific risk management</b>	<b>Scoring cards and registration systems</b> <ul style="list-style-type: none"><li>• Enhance identification systems using biometric features (fingerprint/iris scan) instead of regular identification methods (name, address and date of birth) as already available from the Credit Card industry</li></ul>
<b>4. Government credit guarantee fund.</b>	<b>Credit guarantee funds</b> <ul style="list-style-type: none"><li>• Existing credit houses can be further developed into governmental credit guarantee funds for SMEs</li><li>• Example: SME Guarantee Credit (MKB Borgstellingskrediet) introduced by the Dutch government decades ago. One of ING's predecessors, NMB Bank excelled in this field</li></ul>

# Best Practices for Beijing

- Technological innovations from the microfinance sector

## Mobile banking for rural areas: M-Pesa in Kenya



- M-Pesa is operated by mobile network operator Safaricom
- It enables users to deposit and withdraw from a network of agents, transfer to other users and non-users, pay bills and purchase airtime without visiting a bank
- Affordable payment services with only limited involvement from the bank
- This system could create many opportunities for rural areas in China

## Innovative technologies: Mibanco in Peru



- Mibanco is the biggest MFI of Peru and developed technological tools because of the remote areas she is covering
- The systems are based on a wireless digital network which increases outreach (rural areas) and reduces operational costs
- Biometric devices guarantee reliable client identification. This creates an advanced risk management, integrating monitor of loan- and portfolio performance and establish credit rating at the same time

# Best Practices for Beijing (cont'd)

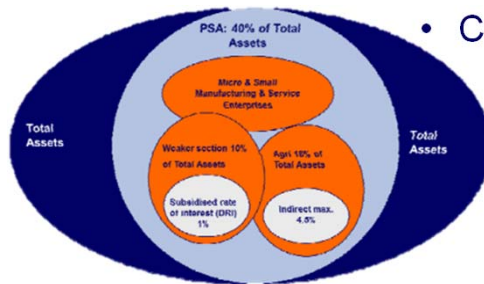
- Connecting investors to borrowers via digital highway with government support

## Alternative funds for MSME: Crowdfunding from USA



- Kiva provides lending to borrowers in developing countries via internet.
- She partners with existing worldwide organizations with expertise in microfinance who disburse Kiva loans to entrepreneurs on Kiva.org when needed.
- Entrepreneur stories and loan details are collected and posted on the website. Lenders select requests they like to fund, from USD25 to the entire amount.
- Lenders can re-lend their funds to another entrepreneur, donate their funds to Kiva or withdraw via PayPal.

## Improving economic development by regulations: Microfinance in India



- India is the biggest microfinance market with ING as one of the most active players
- Commercial banks mandated to invest 40% of their assets in specific areas defined as Priority Sector Advances (PSA), which the microfinance sector is part of. This has given a stimulus to the economic development of the rural areas.
- Common models in the Indian microfinance sector include:
  - Joint Liability Group model where loans are given to groups of entrepreneurs.
  - Securitization where the MFI provides the Bank a credit enhancement in the form of Cash Margin or additional assets while it continues to collect receivables from borrowers.
  - Correspondent model where an MFI acts as intermediary of the bank



# Conclusion

- Microfinance provides a possibility to improve the balance in income distribution between rural and urban areas and within urban populations. Thus help to meet the Inclusive growth strategy of the 12<sup>th</sup> FYP.
- Specifically for the area of Beijing, microfinance can create economic development for the lower end of the market when focused on the MSMEs.

## Explore 2 existing models

Small loan companies	Village/Township banks
<ul style="list-style-type: none"><li>• Financing innovations based on collateral deficiency and moral hazards of SMEs</li><li>• Sector specific risk management</li><li>• Government credit guarantee fund</li><li>• Monitoring from CBRC</li></ul>	<ul style="list-style-type: none"><li>• Product innovations based on clients demand</li><li>• Sector specific risk management</li><li>• Invest in quality of internal management</li></ul>

## Regulatory liberalization

The government can consider stimulating investments into the sector by liberalizing regulations and creating fiscal incentives for private individuals and Financial Institutions

## Best practices

- Deploy the best practices including loans by order, financial lease, collective loans, biometric identification systems, credit guarantee funds and the crowdfunding model
- Learn from other industries like the Credit Card market which also target the mass and have developed advanced automated fraud and credit scoring systems.
- Technological innovations can be a major contributor to effective and efficient business models.



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