

# Study on Inclusive Finance from the Biggest Commercial Banks in China

Shujuan Ding<sup>1</sup>

<sup>1</sup> Economic School, Shandong Normal University, Jinan, China

Correspondence: Shujuan Ding, Economic School, Shandong Normal University, No. 88, Wenhudong Road, Jinan, Shandong Province, P.R. China. Tel: 86-138-5314-0230. E-mail: shjuanding@sina.com

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## Abstract

China is trying to build inclusive finance system. In current stage, micro-credit is the main part of inclusive financing. China's five biggest commercial banks occupied almost 40% of all the credit supplied to peasants and micro-enterprises and therefore play an important role in inclusive finance system although big banks are not efficient in micro-credit market according to traditional theory. This article analyzes the reasons, the problems and suggestions for these five biggest banks to supply micro-credit.

**Keywords:** inclusive finance, big commercial banks, micro-credit

## 1. Introduction

In the year 2005, the United Nations put forward the conception of "inclusive finance system". Suitable and enough financial support is an effective way to relieve poverty (Stiglitz, 1994; World Bank, 2001) and gives impetus for micro-enterprise to develop (Beck, Demirg-Kunt, & Maksimovic, 2005). According to CGAP (2006), for a financial system to be truly inclusive, it should meet the needs of everyone who can fruitfully use financial services, including the poor. Poor people in developing countries, like everyone else, need access to a wide range of financial services that are convenient, flexible, and reasonably priced. Due to the effort of G20, IMF, World Bank, Alliance for Financial Inclusion (AFI) and so on, inclusive finance have been an important strategy for the international society and finance. China joined AFI in September 2011. Although the conception of "inclusive finance" entered China relatively lately, but China has begun to enlarge finance service to the poor, especially to the rural farmer and the micro-enterprise as micro-credit in the early of 1990s. In the early of 1990s, NGOs began to carry out experimental micro-credit to the poor in China. From 1997, China's government began to supply micro-credit to the poor in order to relieve poverty at discount rate through Agricultural Bank of China and Agriculture Development Bank of China. From the year 2000, commercial banks began to supply micro-credit through the promotion of government. In the year 2004 to 2014, Document NO.1 of the Central Government of every year focuses on the "Three Rural Problems (Problems about Agriculture, Rural areas and Peasantry)". One way to solve the "Three Rural Problems" is to increase the financial support to agriculture, rural areas and peasantry. In order to relieve the influence from the financial crisis which began in the latter half of 2007 to China's micro-enterprises, on 19th September 2009, the State Council's "several opinions on further promotion of the development of Small to medium sized enterprises" points out that the difficulties for Medium Sized Enterprises to obtain financial service should be dissolved because they are important to China's economy and society stability. In September 2013, the president of the People's Bank of China, Zhou Xiaochuan expresses that China's inclusive finance will be pushed forward faster in an article from "QiuShi" (Note 1). China's inclusive finance is developing very fast due to the effort of the central and local government. In supplying inclusive finance, China's biggest commercial banks play a very important role although it is not efficient for big banks to deal with micro-credit or micro-finance according to information economics, transaction cost theory and scale matching theory. These theories believe that big commercial banks will face serious information asymmetry when they supply micro-finance to rural peasants and micro-enterprises. And they don't have advantages in looking for and dealing with information. Therefore their transaction cost to screen micro-customers and risk evade are high and therefore it is not a good choice for big commercial banks to supply micro-credit or micro-finance (Yifu Lin, 2001; Paola Sapienza, 2002; Shuguang Wang, 2013). But in China, big commercial banks almost take almost 40% of the micro-credit market. The following parts will describe the situation, explain the reasons, point out the deficiencies

and give the suggestions for these banks to improve supply of micro-credit.

## 2. The Current Situation for the Biggest Banks to Provide Inclusive Finance

The biggest commercial banks include Agriculture Bank of China (ABC), Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB), Bank of China (BOC), Bank of Communications (BCM). In the end of 2013, the five banks' assets occupied 43.3% of the whole banking. There are two basic ways for these banks to take part in inclusive finance, the direct way and the indirect way. The direct way means they supply inclusive finance to micro-enterprise or peasants through their own branches or sub-branches. The indirect way means they supply inclusive finance through other financial institution which may be controlled by these banks. Because the direct way is far more important than the indirect way now, therefore, this article mainly analyzes the direct way.

Table 1. The outstanding loan related to agriculture in the end of year 2013

| Year | Banks                       | ABC   | CCB  | ICBC  | BOC  | BCM  | Total |
|------|-----------------------------|-------|------|-------|------|------|-------|
| 2013 | Outstanding Loan (CNY bil.) | 2348  | 1624 | 2000  | 1065 | 541  | 7578  |
|      | Portion in All Banking(%)   | 11.23 | 7.77 | 9.57  | 5.10 | 2.59 | 36.26 |
| 2012 | Outstanding Loan (CNY bil.) | 2049  | 1275 | 1757  | 931  | 478  | 6490  |
|      | Portion in All Banking(%)   | 11.64 | 7.24 | 9.98  | 5.29 | 2.72 | 36.88 |
| 2011 | Outstanding Loan (CNY bil.) | 1752  | 1050 | 1462  | 625  | 385  | 5274  |
|      | Portion in All Banking(%)   | 12.00 | 7.19 | 10.01 | 4.28 | 2.64 | 36.12 |

Note: in the end of 2013, 2012, 2011, the outstanding loan related to agriculture is separately CNY 20900 billion, 17600 billion, 14600 billion.

Source: Chinese Banking Regulatory Commission Annual Report 2011-2013; Corporate Social Responsibility Report 2011-2013 from ABC, CCB, CCB, BOC, BCM.

Table 2. The outstanding loan related to micro-enterprises in the end of year 2013

| Year | Banks                       | ABC  | CCB  | ICBC  | BOC  | BCM  | Total |
|------|-----------------------------|------|------|-------|------|------|-------|
| 2013 | Outstanding Loan (CNY bil.) | 813  | 989  | 1870  | 918  | 1248 | 5838  |
|      | Portion in All Banking(%)   | 4.58 | 5.57 | 10.53 | 5.17 | 7.03 | 32.87 |
| 2012 | Outstanding Loan (CNY bil.) | 560  | 745  | 1840  | 823  | 1123 | 5091  |
|      | Portion in All Banking(%)   | 3.79 | 5.04 | 12.46 | 5.57 | 7.60 | 34.47 |
| 2011 | Outstanding Loan (CNY bil.) | 575  | 914  | 1690  | 745  | 923  | 4847  |
|      | Portion in All Banking(%)   | 4.66 | 7.41 | 13.70 | 6.04 | 7.48 | 39.28 |

Note: in the end of 2013, 2012, 2011, the outstanding loan to micro-enterprises is separately CNY 17760 billion, CNY 14770, CNY 12340.

Source: Chinese Banking Regulatory Commission Annual Report 2011-2013; Corporate Social Responsibility Report 2011-2013 from ABC, CCB, ICBC, BOC, BCM.

As table 1 and table 2 shows, each of the five biggest commercial banks engages in micro-credit to peasants and micro-enterprises. In the area of micro-credit to peasants, Agriculture Bank of China (ABC) supplies the most and occupies one third of all the micro-credit from the five banks. Agriculture Bank of China (ABC) was rebuilt in 1979 as a special bank to serve the rural area. In the middle of 1990s, state-owned banks' reform began. In 1994, Agriculture Development Bank of China was built up and policy finance was separated for Agriculture Bank of China (ABC) and the left is commercial finance. In the year 1996, Agriculture Bank of China (ABC) began to withdraw sharply from the rural market to reduce the cost. But rural finance became a more serious problem day after day especially after the state-owned banks reform and large-scale branches reduction. In the year 2007, the "national financial work conference" requires that shares system reform of Agriculture Bank of China (ABC) should be joined with the rural financial reform. Therefore Agriculture Bank of China (ABC) is requested to face "Three Rural Problems" and Agriculture Bank of China began to increase the financial service to rural area and it is the only bank that has branches in all counties or sub-county areas. As a consequence of its effort on rural

financial market, it supply the most micro-credit to peasants among the five biggest banks.

In the area of micro-credit to micro-enterprises, Industrial and Commercial Bank of China (ICBC) performs the best among the five banks. In 1984, Industrial and Commercial Bank of China (ICBC) was built as a special bank to serve the enterprises and residents in urban area. And therefore it has the basis to serve micro-enterprises. After the year 1995, ICBC began to change from a special bank to commercial bank. From April 2005, ICBC began its share corporation reform. In recent years, ICBC regards supporting micro-enterprise as an important way to serve the real economy and keep on strengthening and innovating kinds of financial service that are suitable for micro-finance. ICBC has organized an independent system to serve micro-enterprises. By the end of July 2013, ICBC has set up 1443 special institutions to serve micro-finance and built a team of more than 15000 customer managers to serve micro-credit. As a result, ICBC is the bank that supplies the most credit to micro-enterprises among the five biggest commercial banks. It occupied about one third of the whole outstanding loan from the five banks.

The five banks occupied more than 36 percent of the whole outstanding loans to peasants in the year 2011 to 2013. They occupied almost 40 percent of the whole outstanding loans to micro-enterprises in 2011, and still more than 32 percent in 2012 and 2013. Therefore they play an important role in China's inclusive finance especially Agriculture Bank of China (ABC) and Industrial and Commercial Bank of China (ICBC).

### **3. The Reasons for the Biggest Commercial Banks to Provide the Inclusive Finance**

According to the traditional theory, big commercial bank is not suitable to supply micro-finance, but in China, the biggest commercial banks play a very important role. Why?

#### *3.1 The Impetus from the Government Is a Very Important Reason*

In order to enlarge the supply of financial service to peasants and micro-enterprise, kinds of regulations from the government appeared. For example, Agriculture Bank of China (ABC) is required to face the "Three Rural Problems (Problems about Agriculture, Rural areas and Peasantry)". Document NO.1 of the Central Government from 2004 to 2014 focuses on the "Three Rural Problems"; In 2009, the State Council's "several opinions on further promotion of the development of small to medium sized enterprises" require that more financial service should be given to micro-enterprise. And the most important is the requirement of "two 'no less than'" from China Banking Regulatory Commission which is put forward in 2010. "two 'no less than'" means the increment velocity of credit amount to peasants and micro-enterprise should be no less than that to the whole society and the increment of credit should be no less than that of the last year. In 2011, the objective of "two 'no less than'" is cancelled because of the tight credit environment and in 2012, it is recovered. And in fact, from 2009 to 2013, the banking has realized the objective for five years.

#### *3.2 Social Responsibility of Big Enterprise Is Another Reason*

Enterprise' social responsibility means that an enterprise should undertake the responsibility to staff, society and environment when it creates profit and is responsible to its shareholders. Enterprise, especially big enterprise should perform its social society. Financial support is an effective way to relieve poverty and everybody has the right to obtain convenient and flexible financial service with reasonable price. In China, peasants and micro-enterprise can not obtain enough financial service for a long time. Therefore, it's a social responsibility for banks especially the biggest bank to supply convenient and flexible financial service with reasonable price to these disadvantaged groups, although the service to them may be unprofitable. These five banks are the biggest in China's banking and more than half of the shares belong to the state, and therefore they should undertake the social society especially in the stage that financial service to peasants and micro-enterprises may be costly and unprofitable.

#### *3.3 That Financial Services to Peasants and Micro-Enterprises May Be Profitable Is Also a Reason*

According to the traditional theory and traditional loan pattern, when big bank supplies financial service to peasants and micro-enterprise, the credit amount is much smaller than that to large enterprise, therefore interest income will be far less, but the cost and the risk may be the same or higher because the customer may located in far-away rural areas and they don't have enough mortgage. Therefore, big banks are reluctant to supply credit to peasants and micro-enterprise. But the financial market' competition, especially in the big-enterprise market is severer, and the financial market that was ignored may be another profit resource. And in fact, this financial market that serves the peasants and micro-enterprise may be an attractive market when suitable loan patterns are adopted. In this market, the prominent problem is the shortage of mortgage or guarantee. These biggest banks have used kinds of effective way to solve this problem. Joint-guarantee is a popular pattern. Joint-guarantee means several peasants households or micro-enterprises (usually three or five) constitute an alliance to guarantee for each other.

This way can reduce sharply the risk of breach of contract. "Industry chain financing" means that the financial institution investigates the credit situation of a big enterprise which is the core of an industry chain. Then the financial institution may supply loan to many micro-enterprises that are in this industry chain. For example, from the beginning of 2013 to October of 2013, Industrial and Commercial Bank of China (ICBC) had expanded more than 10 thousand of micro-enterprises as customers according to the good credit situation of about 1300 core and big enterprises in respective industry chain. There are another similar loan pattern called "business circle financing". These two ways can also solve the problem of information-asymmetry. In fact banks are more willing to enter this market face peasants and micro-enterprises than before.

#### **4. The Problems and Suggestions for the Biggest Commercial Banks to Serve Inclusive Finance**

Peasants and micro-enterprises still can not obtain enough financing, and the financing price is still high. Only about 20 percent micro-enterprise can obtain financing and the interest rate is about 60 percent higher than the average level. Only 10% peasants can obtain financing according to the field-investigation of Shandong rural area in the early 2014 carried out by Shandong Normal University, P.R. China. Therefore more inclusive finance should be supplied by the biggest commercial banks.

Joint-guarantee can release the risk faced by the biggest commercial banks. But when a member that obtains loan from the biggest commercial banks breaches the contract, the guarantors' regular life and production will be damaged and maybe some of them may go bankruptcy and these kinds of affairs really happened in China.

"Industry chain financing" is a good way for commercial banks especially for big commercial banks to use in inclusive financing. This kind of financing way can solve the information asymmetry. It can also make the commercial bank to realize "bulk credit" which is particular suitable for big commercial banks. The commercial banks can supply to a large quantity of customers that in the an industry chain once they have investigate the core enterprise of that industry chain only for one time, which means large commercial banks can also supply a great deal of credit to micro-enterprises just like to big enterprise. The cost will be reduced largely. Besides, the biggest commercial banks will have more advantages when they face an industry chain that is all over the country. But unfortunately, in China, industry chains are insufficient, which means large number of micro-enterprises and peasants are not in an industry chain. And the problem of business circle financing is also similar, there are not enough business circles in China and many peasants and micro-enterprises are not belonged to a business circle.

So how to supply more inclusive financing to peasants and micro-enterprises?

Firstly, the government's coordination is needed. How to solve the problem of mortgage is typical important to obtain more credit. It is known for all that most peasants' approved mortgage is few. Their property that can be proved is forest ownership right, contractual operation right of land and homestead land use right, but the "three rights" can not be freely transferred currently. In order to realize the circulation of the "three rights", government's strength is needed. According to "Guarantee Law" and "Property Law", the mortgage of contractual operation right of land and homestead land is forbidden. But in 2008, "Third Plenary Session of the Seventeenth Central Committee of the Communist Party of China" points out that the circulation of contractual operation right of land is permitted. There's no law restriction of circulation and mortgage of forest ownership right. Although there are some law conflicts, the experiment of the mortgage of the "three rights" has been carried out in the effort of the government. In order to solve the problem of information asymmetry and reduce the overall cost of information seeking, the set up of Credit System is very important. China's government is pushing forward the construction of micro-enterprise credit system and rural credit system. In order to attract more commercial banks to enter this inclusive finance, some bonus, tax preference and financial business preference are needed.

Secondly, the biggest banks should join in inclusive financing with more ways. They should develop more credit patterns to serve the peasants and micro-enterprises. An important way is to connect closely with local situation. For example, when supply credit to peasants, the commercial bank can employ a local resident as "loan officer" who is familiar with the credit status of local residents and he can provide information to the commercial banks. Another important way is to join in inclusive financing indirectly. It is true that when big commercial banks supply credit to one customer, they don't have advantages compared with small-size local banks. But they can join in small-size local banks though capital injection.

Thirdly, the biggest banks should also control the risk and develop not too fast. It is unavoidable that the risk in market to peasants and micro-enterprises is higher than the average level. And it is a new career for these banks and some risk is unavoidable. Therefore the risk control should be paid much attention to. Besides, although inclusive finance is a career that highly encouraged by the government, the commercial banks should not develop too fast in this area. The basic rule is stable operation. Once they develop too fast, the risk may be large and the profit may be low, which will damage the enthusiasm to supply inclusive financing.

## 5. Conclusions

The five biggest Chinese commercial banks play a very important rule in China's inclusive finance market because of the impetus from the government, the social responsibility and the profitable prospect once with suitable loan pattern. There are still some problems for the biggest commercial banks to supply micro-credit. For example, the effective loan pattern "joint-guarantee" and "industry chain financing" face many obstacles. In order to supply more micro-credit, the government and the superiority should give a certain help, the biggest commercial banks should join in inclusive financing with more ways and control their own risk and develop steadily.

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## Note

Note 1. "QiuShi" is an Organ of the Central Committee of the Communist Party of China.

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