IFC International Finance Corporation
WORLD BANK GROUP

Executive Summary of Evaluation

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Author of Final Report of Evaluation	*Chaoying Liu, IFC-CDI, CLiu@ifc.org;* *Yanni Chen,IFC-CDI, YChen@ifc.org*
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Author of this Executive Summary	*Chaoying Liu, IFC-CDI, CLiu@ifc.org;* *Yanni Chen,IFC-CDI, YChen@ifc.org*
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Executive Summary Approved for public disclosure by (name) on (date)	*Anna Hidalgo, IFC-ECRIO, AHidalgo@worldbankgroup.org*

Background

Over the past thirty years, China's financial sector has experienced a tremendous transformation, evolving from a mono-bank system into a multi-player sector with some of the world's biggest banks. IFC, the member of the World Bank Group that promotes private sector development in developing countries, has since 1995 provided a range of services in China, including advisory, equity investments, loans, and risk management products, to support the development of the country's financial sector.

Empirical research has demonstrated a strong positive link between the functioning of the financial system and long-term economic growth. It also has shown that financial development disproportionately boosts incomes of the poor and reduces income inequality, and therefore has an impact on poverty reduction.

Objectives

The primary objective of this study is to systematically assess and summarize the development results of key IFC activities in supporting financial sector reforms in China over the past twenty years. Unlike an impact evaluation, a review is not an attempt to measure the attribution of IFC's intervention. Rather, it is intended to consolidate, validate, and elaborate on a wide range of evidence recorded in project documents by hearing from clients and partners about IFC's contributions, and thereby learn useful lessons that could guide IFCs future work in China and other countries.

The scope of the review focuses on three IFC operations areas: Investment Operations, Advisory Services, and local-currency financing, and covers four broad topics:

- Policy, regulation, and financial infrastructure, including secured transactions, the
- Credit reporting system, and green credit policy;
- Commercial banks;
- Microfinance and non-bank financial institutions; and
- Capital market development, focusing on local-currency financing.

IFC Interventions and Results

Since1995, IFC's support for financial sector reform in China has advanced through three phases: exploration, expansion, and frontier focus. The operations in each phase were designed and implemented in response to the changing challenges faced by the sector and were guided by a dynamic IFC strategy that evolved as the Chinese economy evolved. By adopting this dynamic strategy, IFC's additionality was maintained and its relevance to the market and to regulatory objectives continued.

- **IFC helped create an enabling environment for the maturation of China's financial services:**

IFCs Advisory Services projects related to secured transactions assisted the People's Bank of China (PBOC) to draft the relevant articles of the country's 2007 Property Law and contributed to the establishment of a single, centralized accounts receivables registry – the Credit Registry Center (CRC). IFC also helped PBOC issue ministry-level regulation shaping the Consumer Credit Information Database in 2005 and then used the regulation to help establish a nationwide consumer credit database the next year. IFC also has worked closely with a number of governmental and non-governmental organizations to provide sector wide capacity-building activities for financial and non-financial institutions in China, with the objective of addressing their weaknesses, while improving their efficiency and competitiveness.

Other policy and regulatory areas that IFC has supported include housing finance and a green credit policy. IFC‟s Performance Standards and the Equator Principles are being used as benchmarks and guiding standards in the implementation of China's Green Credit Policy, and are now well-established within key Chinese banks. The IFC-China Green Credit partnership model has been expanded to other countries in the EAP region including Vietnam, the Philippines, Malaysia, and Indonesia.

- **IFC helped expedite the transformation of China's commercial banks:**

Between 1999 and 2009, IFC made equity investments in eight Chinese commercial banks totaling \$471.7 million[1], starting with Bank of Shanghai in 1999 at a time when the Chinese banking sector was plagued with a heavy load of non-performing loans and was considered highly risky. Through its investments and advisory services, IFC helped introduce international best practices in banking management to these banks, established and strengthened risk management capabilities, improved corporate governance, and sharpened the banks‟ focus on serving small and medium-sized enterprises (SMEs). IFC also pioneered the China Utility-Based Energy Efficiency Finance Program (CHUEE) with Chinese commercial banks, which combines a risk-sharing facility with an advisory program to directly stimulate energy efficiency financing.

The types of commercial banks that IFC invested in together account for only a small share of China's financial system, starting at about 16 percent of the country's total financial sector assets in 1999 and remaining below 25 percent in 2010. However, by building the capacity and enhancing the competitiveness and sustainability of best-practice "role model banks," IFC contributed significantly to the overall development of the banking sector. Client banks that the research team visited said that strengthened competitiveness of the smaller-bank segment has helped increase competition for the

[1] Updated information on IFC's investments can be located at https://finances.worldbank.org/ifc

entire banking sector, which has improved services to the underserved sectors of the economy such as SMEs.

- **IFC supported the development of the microfinance industry:**

Following its model for helping transform China's commercial banking sector, IFC had a clear strategy on what it intended to do with China's microfinance sector, again by combining advisory and investment activities and intervening at the policy, sector, and institutional levels simultaneously. At the policy level, IFC helped the government formulate the regulatory framework. At the sector level, IFC worked with several market players to educate the market and disseminate best practices on microfinance operations. At the institutional level, IFC made equity investments in and provided advisory services to eleven Chinese institutions offering microfinance. Two more such investments are in the pipeline. IFC helped the firms develop strategy, conduct market studies, formulate business plans, develop information management systems, train staff, and introduce international operational knowledge on microfinance into China.

- **IFC supported the development of China's capital market:**

From 2005 to 2011, IFC carried out three RMB bond issues in Chinese mainland and Hong Kong SAR markets, with total proceeds of RMB2.15 billion. In 2012, IFC became the first multilateral institution authorized to conduct transactions with Chinese banks in the domestic currency swap market. With these local-currency products, IFC has been able to support high-quality domestic companies that needed long-term local-currency financing. Most of these companies were not able to access the bond market directly for financing, and short-term funding from banks was inappropriate for their capital-intensive operations such as business expansion or research and development.

Conclusions and Recommendations

China has made impressive achievements in financial sector reform over the past twenty years. The main conclusion of this review is that while the Chinese government has led the primary effort behind the sector's achievements, IFC has made significant positive contributions as an active investor, technical advisor, facilitator, and knowledge broker.

A key goal for the review is collecting and synthesizing – from IFC projects documents and management and staff, government, clients, and beneficiaries – many of the valuable lessons that IFC's long-term work with China's financial sector offers for future operations, in China and elsewhere.

Coordinating reform efforts with the Chinese government, and working with competent and committed clients – from both government and banks – were the key factors for IFC's success in this country. Intervening at all levels at once: regulatory and policy, sectoral, and institutional proved important, along with other success factors such as:

- Remaining relevant to the government's strategic priorities and reform agenda;
- Having a dynamic strategy that addressed major issues as they emerged;
- Maintaining a close working relationship with the government as a trusted partner;
- Taking calculated risks when warranted;
- Combining a strong local team and top-notch international expertise; and
- Co-investing and collaborating closely with other strategic investors.

All of these approaches enabled IFC to have a significant impact. In addition, IFC's multicultural environment and organizational matrix worked to its advantage. Finally, IFC's remaining true to its values and mission also was critical.

The review also identified several issues that hindered IFC's success, from which we take the following lessons:

- Being supply-driven is a recipe for failure;
- Better allocation of resources and a better funding instrument for advisory services
- Could have improved results and efficiency, in some cases.
- Timing and mode of entry in less-developed areas needs to be carefully planned out; and
- Taking small stakes can result in limited influence for IFC.

Clients interviewed by the research team expected IFC to be faster, more efficient, and more flexible, to offer more customization, and to maintain greater continuity in relationship management.

Looking ahead, China faces tremendous development challenges that create opportunities for IFC to continue its partnership and support, especially with respect to climate change and other environmental issues. China's growth also offers chances to support greater financial access for micro, small and medium-sized enterprises (MSMEs), particularly in the rural and microfinance sectors, and for promoting South-South cooperation.