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BRIEF

Crowdfunding in China: The Financial Inclusion Dimension

When crowdfunding emerged in the United Kingdom around 2007, few could imagine that 10 years later China would be the largest crowdfunding market in the world. Peer-to-peer (P2P) lending in China started picking up in 2011 to reach a market volume of US$52.44 billion in 2015 (Zhang et al. 2016). It surpassed the US$100 billion threshold a year later, thus leaving North America far behind as the second largest global market with a "modest" US$36.16 billion in crowdfunded loans (Wardrop et al. 2016). Led by well-known platforms, such as CreditEase, Renrendai, ppdai.com, Yooli.com, and others, China's P2P industry continues to grow.

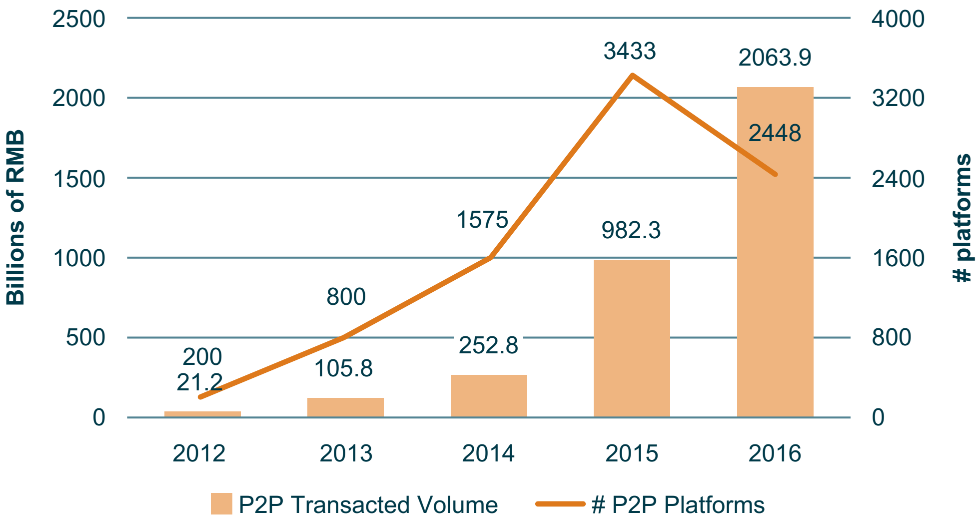
The unprecedented growth of the industry has improved access to finance for individuals and small and medium enterprises (SMEs). This growth was driven by a mix of circumstances, including low interest yields on savings accounts, widespread online connectivity, and cheap smart phones. The growth of the P2P space was also a reaction to the indifference traditional financial institutions have shown to serving individuals and SMEs. The P2P lending revolution has also had its challenges, including platform failures and fraud, the largest of which has been the E'zubao Ponzi scheme, which exposed 900,000 investors to losses upwards of US$7 billion. Although the number of failing platforms has steadily grown, the volume of P2P loans continues to rise. This may be because more established platforms and those with ties to government and financial institutions have continued to grow (Figure 1).

Categories of Crowdfunding in China

In the crowdfunding space, P2P lending is joined by donation-based, reward-based, and equity crowdfunding (Kirby and Worner 2014) (Figure 2). Donation-based crowdfunding is rather novel, in part, because philanthropic activities and mindsets are also relatively new in China. For instance, Shilehui, one of the oldest charity crowdfunding platforms (operating since 2009) claims to have 175,226 donors and a total of US$19.2 million donated—modest numbers for China. Reward-based platforms are closely intertwined with e-commerce through major Chinese technology companies, particularly Alibaba, Tencent, and Jing Dong, which build multifunctional platforms for e-commerce and online retail services. At the end of 2015, the sector was estimated to reach US$813 million (China Internet Finance Annual Report 2015).

By comparison, equity crowdfunding remained relatively small at US$769 million raised in 2016 (Yingcan Consulting Company 2017). However, the central government has continued to outwardly support equity crowdfunding so steady growth is likely to return. The largest equity crowdfunding platform is Jing Dong Dong Jia (a part of Jing Dong), with US$83.9 million raised across more than 70 projects in just the first six months of 2016. The next largest, 36Kr, raised US$31.9 million during that same period (01 Caijing 2016). The top eight platforms accounted for roughly 50 percent of the total equity crowdfunding market; Jing Dong is at the top with more than 10 percent of the market (China Internet Finance Annual Report 2015). A branch of equity crowdfunding is real-estate crowdfunding, which gained greater attention only in 2015 and can be divided into three models (Raphael 2015): (*i*) investment (e.g., Ping An fang), (*ii*) auctioning (e.g., Vanke), and (*iii*) cooperative investment (e.g., 17 Housing).

Figure 1. P2P Transacted Volume and Number of Platforms



Source: WDZJ.com

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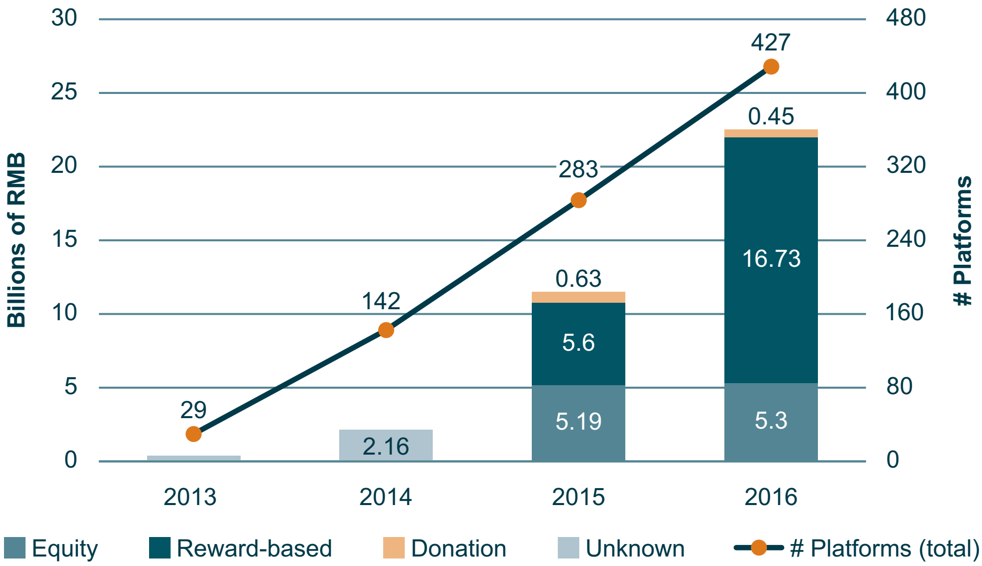
Figure 2. Crowdfunding in China (P2P lending excluded)



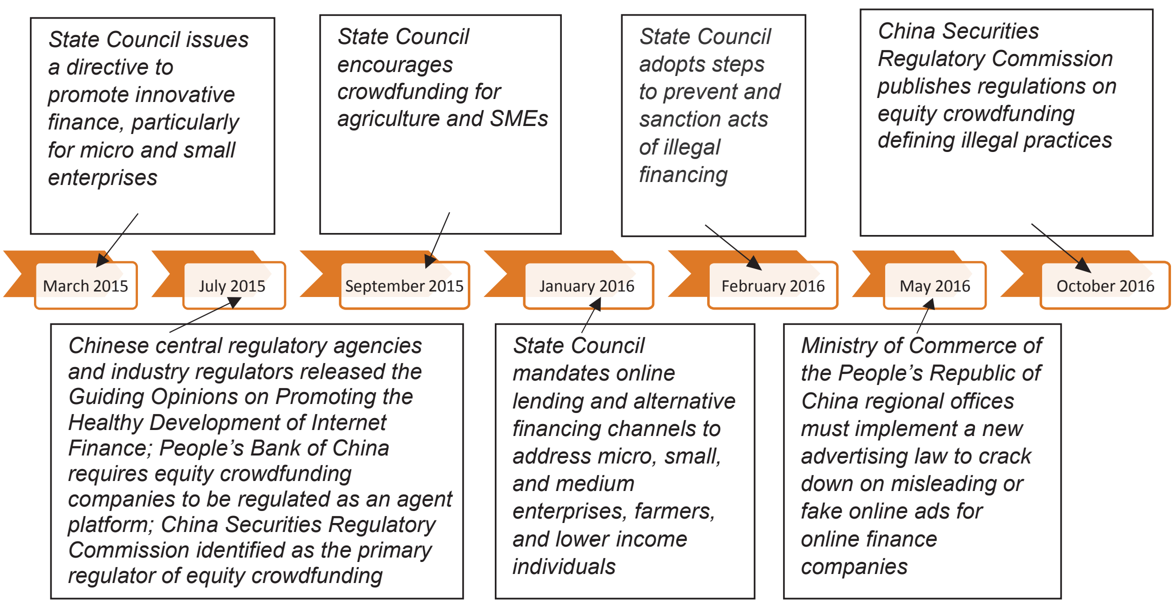
Source: WDZJ.com

Regulatory Intervention

The tremendous growth of crowdfunding in general and P2P lending in particular has been enabled by the relevant authorities' wait-and-see approach toward regulation and supervision of the nascent industry. From 2007 up until only recently the government essentially allowed P2P platforms and other online financial companies to operate without setting a legal and regulatory framework. As a consequence, the number of platforms skyrocketed, and they developed practices that may not always be considered "healthy innovations": (*i*) pooling, slicing, and packaging of underlying loans (a process not too distant from securitization), (*ii*) guarantee of repayment and financial returns without proven capacity to deliver, and (*iii*) shadow banking-like maturity transformation.

The initial combination of self-regulation and ad hoc oversight by local authorities led to inconsistencies: many platforms operated under different regimes according to different requirements issued by city or province authorities. Prompted by failures and scandals, including the E'zubao Ponzi scheme, the government started tightening regulation in 2015. Figure 3 captures regulatory and policy milestones. Due to the regulatory changes (e.g., mandatory requirement to open a custody account at a bank), the number of P2P platforms has decreased from more than 3,000 platforms in 2015 to 2,448 in 2016, and

Figure 3. Examples of Policy Interventions



the number is estimated to fall to around 1,200 platforms by the end of 2017 (P2P Industry Annual Report 2017).

Implications for Financial Inclusion

The central government realizes the potential P2P lending has for the retail financial segment, which was neglected by banks for years, particularly in rural areas. As a result, the State Council has, for several years, described China's rapidly growing digital finance industry as a strategic sector to provide finance for the unserved and underserved, as illustrated in its five-year plan for financial inclusion.[1] Some authorities have carried out specific measures. For instance, in 2015 the People's Bank of China (PBOC) launched a pilot to promote rural development through P2P lending.[2] The pilot entailed pairing four P2P platforms that offer specialized loans to farmers and business loans to SMEs with PBOC's Guangzhou branch to observe how each platform (PPmoney, Guangzhou e-Loan, D.C. Finance, Zhengqin Finance) can contribute to the economic development of rural areas.

However interesting, such pilots remain rather symbolic because most of the market has been developing organically. In 2016, P2P lending platforms were responsible for 3 percent of all retail loans advanced by the Chinese financial sector (Mittal et al. 2016) to millions of borrowers (2.7 million only in April 2017). On average, P2P lending has offered an opportunity to 4 million investors every month, many of them individuals getting financial return on their savings at rates previously unavailable.

Neither donation-based nor reward-based crowdfunding business models are considered a financial service. However, they can become a gateway to a formal economy for smallholders who can use them to market and sell their

Box 1. Distinctions in Chinese Crowdfunding Terminology

China is different from other markets not only in respect to its high volumes, but also because of the particular terminology used to refer to digital finance generally and crowdfunding particularly. The commonly used term ***digital financial services*** often translates into ***internet finance*** or ***online finance*** and is also loosely used to refer to technology-driven financial innovation (FinTech), alternative finance, and P2P lending. The Chinese term for ***crowdfunding*** broadly refers to donation-based, reward-based, and equity crowdfunding, while P2P lending is a separate category. These nuances complicate work of both Chinese and non-Chinese researchers and crowdfunding professionals. The following attempts to shed some light on the terminology.

Digital Financial Services Terminology		
Online finance Internet finance FinTech	互联网金融	Can mean several different things, depending on the context. A catch-all term that emphasizes platform-based finance.
Crowdfunding	众筹	Most often refers to financial platforms wherein individual investors actively participate in the selection of unique projects to invest in (often excluding P2P platforms).
P2P lending	P2P 借贷平台 债务众筹 / 债权众筹	Platforms most often match users on the back-end, and users invest only in products of fixed interest and maturities. As such, P2P platforms are treated as alternative product providers to banks and discussed separately from other crowdfunding.
Crowdfunding Terminology		
Reward-based crowdfunding	奖励类众筹	These four terms are all used by different websites and researchers, often to refer to the sum of all of these crowdfunding models. This ambiguity causes discrepancies in data.
Benefit-based crowdfunding	权益众筹	
Donation-based crowdfunding	捐赠众筹	
Product-based crowdfunding	产品众筹	
Equity crowdfunding	股权众筹	There is a more straightforward taxonomy for equity crowdfunding; however, many platforms integrate multiple types of crowdfunding, making comparison difficult.
Real-estate crowdfunding	房(地)产众筹	An independently labeled subcategory of what might be a type of debt-based crowdfunding.

1 http://www.gov.cn/zhengce/content/2016-01/15/content_10602.htm
2 See, e.g., http://www.gzifa.org/hyxw/281.

products, thus building digital records of their business transactions, which may further improve their ability to access credit from banks and other traditional lenders. Reward-based crowdfunding in agriculture amounted to US$25.3 million across 2,194 rural product projects in 2015. Although these channels are much smaller than China's P2P lending market, they are innovative and may prove to be a better means of servicing certain target groups. For example, D.C. Finance allows farmers to offer their agricultural products in exchange for financing, thus expanding their outreach to urban customers and improving their prospects of growth.

To measure exact impact of crowdfunding and P2P lending on excluded and low-income consumers, more granular data are required. The limited detailed data available makes it hard to quantify the actual impact of crowdfunding on financial inclusion. However, large volumes and rapid growth speak to the potential of crowdfunding to offer material solutions to some of China's most long-standing challenges to providing accessible finance. There are also several notable challenges ahead, including regulatory and supervisory capacity, uneven playing field and regulatory arbitrage, persistent lack of transparency, and low financial capability, particularly in rural areas.

To the extent to which China shares similarities with other emerging markets and developing economies, Chinese experience can serve as a lesson to policy makers looking at crowdfunding as a means of promoting financial inclusion and the financial sector. This is certainly true for issues of general relevance, such as the need for timely regulatory intervention balancing opportunities with risks. While China has pursued the wait-and-see approach, policy makers in other jurisdictions may consider other options, such as setting up a regulatory sandbox.[3] Even in areas where peculiarities of China's market (high online connectivity, high smartphones penetration, blooming e-commerce) may not be easily replicated, the evolution of the crowdfunding market is worth following because it offers interesting insights into linkages between crowdfunding and financial inclusion.

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[3] See, e.g., GPFI (2017, p. 12).

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