Small Loans, Big Profits: The Consumer Finance Market in China

Since early 2015, consumer finance companies have been some of the hottest investments in China. At least 70% of Chinese venture capital and private equity investments in finance went to consumer finance-related companies in 2016, for a total of CNY 93 billion (USD 13 billion), according to Chinese newspaper the People's Daily.

Early Days of Consumer Finance in China

The first four pilot consumer finance companies were established in 2009: Bank of China Consumer Finance, Bank of Beijing Consumer Finance, Jincheng Consumer Finance and Home Credit Consumer Finance.

The Chinese government under President Xi Jinping has supported the development of the consumer finance sector as part of its policy of "inclusive finance" and its goal to drive economic growth through domestic consumption. In 2016, in the Report on the Work of the Government, Premier Li Keqiang emphasized the importance of developing consumer finance services to serve people with low to medium incomes and release their spending potential. In December 2016, the China Banking Regulatory Commission ("CBRC") held a press conference to recognize the positive effect of consumer finance companies in boosting consumption and improving people's livelihoods.

Consumer finance companies are licensed by the CBRC. At the end of 2016, the consumer finance industry had issued a total of CNY 208.436 billion (USD 30 billion) in loans and had served 24.14 million customers in China. Licensed consumer finance companies have increased from the four pilot companies to over 20 since 2009, most of them backed by banks.

Companies without a consumer finance license are getting their piece of the pie by acquiring online small loan licenses. As of November 2017, over 200 online small loan licenses had been issued across the country. These firms, however, are at a disadvantage compared to licensed consumer finance companies since they do not have access to individual credit data kept by the People's Bank of China and they cannot borrow at the interbank rate.

The Pioneers

According to research published in 2016 by Tsinghua University, the earliest established consumer finance companies have the most offices and the best market penetration. Taking accessibility and quality of service into consideration, the report ranked the top four consumer finance companies in China as:

- Home Credit Consumer Finance
- Bank of China Consumer Finance
- Bank of Beijing Consumer Finance
- Postal Savings Bank of China Consumer Finance

At the top of the list, Home Credit Consumer Finance had operating revenue of CNY 6.8 billion (USD 971 million), with CNY 930 million (USD 133 million) in net profit in 2016. Bank of China Consumer Finance's operating revenue was CNY 2.35 billion (USD 336 million) and its net profit was CNY 537 million (USD 77 million).

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Everyone Wants its Slice of the Pie

Compared to around 2013 and 2014 when there were few market competitors, today it takes more effort for consumer finance companies to gain new clients, as both traditional retailers and e-commerce companies have joined the fray.

Traditional Retailers

Consumer finance companies traditionally partnered with retailers and posted sales agents in stores to promote their services. Retailers, having seen how lucrative the business is, have formed their own in-house teams to provide product loan services to their customers.

One of the largest retailers in China, Suning Appliance Group, obtained a consumer finance license from the CBRC in December 2014 for one of its subsidiaries. Suning started offering cash and product loans to customers in 2015. It now makes loans at 1,600 locations to 300 million members.

E-commerce Companies

Online retailers are also able to provide loan services by acquiring online small loan licenses. Leading e-commerce groups like JD.com and Alibaba are rapidly dominating the online consumer finance market.

Since February 2014, for example, JD Baitiao, the consumer finance division of online retailer JD.com, has allowed its online shoppers to buy products first and repay in installments. Alibaba e-commerce platforms offer a similar product, Mayi Huabei.

As online shopping and mobile payments continue to take market share, e-commerce companies, which are experts in big data and consumer behavior, may have a strategic advantage over consumer finance companies.

Small Loans, Big Profits, No Risk?

Consumer finance companies in China have huge growth potential, but are not without their own risks.

Interest Rate Cap

Consumer finance companies and loan companies are operating in a legal grey area regarding the interest rate they can charge borrowers. In order to get around the interest rate cap of approximately 25% in China, consumer finance companies often charge various fees. This practice is vulnerable if the CBRC tightens its regulations.

Loan Collection and Disputes

Media reports on illegal loan collection and campus loan disputes have attracted public and government attention on the negative impact of consumer finance on some people's lives. Since around 2015, a number of college students were reportedly in deep debt and some have even committed suicide due to debt pressure. In August 2016, the CBRC issued regulations for campus loan companies that explicitly prohibited certain loan collection practices and misleading advertising. As the customers of consumer finance companies often pose a higher credit risk than the customers of banks, managing loan collection will be an ongoing concern.

Sector Diversification for Higher Profit Margins

Consumer finance companies in China initially focused on financing purchases of consumer electronics. As competition intensifies, they plan to diversify into loans for education, cosmetic surgery, home decoration, travel and other high-margin sectors. As the credit analysis and financing models that companies use for consumer goods cannot be easily applied to other products, time is needed for companies to develop best practices.

High Employee Turnover and Internal Issues

In March 2016, at the height of new entrants to the market, about 300 employees of industry pioneer Home Credit Consumer Finance left to join new consumer finance companies. Quick expansion and new players joining the market not only accelerates employee turnover, but also can reveal various internal management issues within companies.

A New Bubble?

Consumer finance is now a big topic in China but, as with any other industry, it risks becoming another investment bubble. Since 2017, policy direction has shifted to focus more on the risks underlying this booming market. Since 11 November 2017, businesses offering consumer finance services in the Chinese province of Chongqing are required to self-audit their operations, including their sources of funding, interest rates and fees, loan collection methods, and consumer complaints. The market interpreted the announcement as a signal of tightening regulations, which would be followed by local governments elsewhere.

About Blackpeak

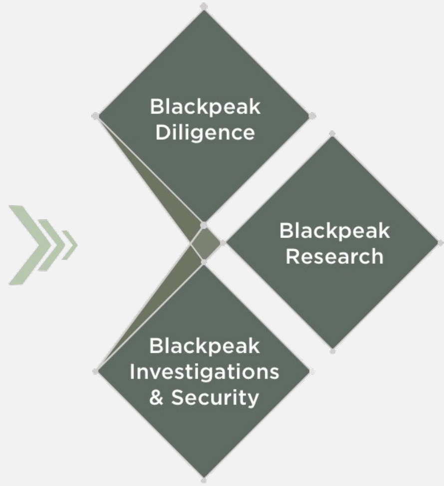
Blackpeak is an international investigative research firm.

Founded in Asia, the firm now operates from strategic locations in key financial and economic centers, including Hong Kong, Singapore, Tokyo, Shanghai, Beijing, Guangzhou and New York.

We handle highly complex research assignments, including integrity due diligence, internal and external investigations, asset searches, business intelligence for institutional and hedge fund investors, stakeholder mapping, political risk research and more.

Over 350 clients rely on Blackpeak's services, including the world's leading investment banks, corporations, law firms and asset managers.

Blackpeak's team has extensive experience in the consumer finance industry and we are happy to help our clients to identify risks before they invest in these companies.



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