



# China's FinTech Industry

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Traditional financial centers such as London and New York are witnessing increased competition from Chinese cities like Shanghai and Shenzhen with the rise of FinTech. While China's traditional financial sector is relatively undeveloped and restricted from foreign participation, the country's Internet Finance, or Financial Technology (FinTech), industry has developed rapidly in recent years with an outburst of innovations and startups.

Now, China is in many respects a leader in this emerging industry. By the end of 2015, the country had 500 million FinTech users, and its overall market size exceeded RMB 12 trillion (US\$1.87 trillion). Four Chinese companies, namely Tencent, Alibaba, Baidu, and JD, were also amongst the top 10 public internet companies in the world. In 2016, China had eight of the world's 27 FinTech "unicorns"- companies that investors value at more than US\$1 billion.

By any measure, China's FinTech industry is rapidly expanding, presenting opportunities for both FinTech companies and complementary firms. However, like China's traditional financial sector, foreign participation in the industry can be challenging.

## China's FinTech landscape

There are several reasons why China's FinTech industry has developed so rapidly. The Chinese government's supportive policies and its loose regulatory environment have been conducive to innovations and developments in the industry. The industry has also helped to serve the demands of groups that were previously excluded from traditional banking, such as small and medium sized enterprises (SMEs) and low-income earners. Further to this, Chinese consumers are more open to sharing data, especially the generations of the 1980s and 1990s who are the main users of FinTech.

With the rapid development of the industry, there are many different opportunities for both young and established FinTech firms alike. Different players, each with their own strengths and weaknesses, are doing what they can to seize upon these different opportunities. These players can be grouped into three main categories, per a report released by McKinsey.

### Internet disruptors

The first category of players is internet disruptors. These companies are responsible for most high-profile innovations that have disrupted China's traditional finance industry, and receive the most public attention. Most notably, this category includes well-known internet giants **Baidu, Alibaba, and Tencent (BAT)**.

Millions of people use Tencent's WeChat Pay and Alibaba's Alipay daily to make **third party mobile payments**. By the end of 2015, China's third party payments transaction volume was over RMB 10 trillion (US\$1.56 trillion), which easily surpassed US and EU leaders such as Paypal. With their all-encompassing digital platforms and extensive ecosystems that penetrate the daily lives of consumers, players in this category can collect massive amounts of data, which they can use to their advantage by predicting consumer behavior and offering more personalized and **innovative products**.

As well as offering third party payments, internet disruptors are also active in other segments of China's FinTech industry, including the rapidly expanding segment of wealth management. Alibaba has expanded into



wealth management with its Yu'e Bao, which had RMB 700 billion (US\$109.34 billion) of assets under management (AUM) within just two years to become the second largest money market fund globally. China's national credit rating system is also relatively underdeveloped, and players in this category are using the large amounts of data they have to develop credit rating scores for individuals. Alibaba's online credit rating agency 'Sesame Credit' is the most prominent example.

### **Traditional financial institutions**

The second category of players is the traditional financial institutions. Although FinTech and other players in the industry could be viewed as a threat to them, these players are eager to harness the advantages of FinTech innovations so that they do not miss out on the opportunities within the industry.

To make the most of the opportunities, many traditional financial institutions have published internet finance strategies. The Industrial and Commercial Bank of China (ICBC) has published its 'e-ICBC' internet finance strategy, which offers a range of products and services in the areas of payments, financing, and wealth management. ICBC and other traditional financial institutions are able to offer a range of professional products and services developed from years of experience and institutional knowledge. The high profitability of the traditional banking sector has also put it in a strong position to invest in the FinTech industry.

However, compared to other FinTech players, traditional financial institutions face stricter regulations and are more conservative in their approach, which means they are followers rather than leaders in the industry. To put themselves in a more advantageous position, traditional financial institutions have formed partnerships with players in the other categories. For example, China CITIC Bank founded Baixin Bank with internet search engine giant Baidu, and the Bank of Beijing is collaborating with Tencent. This shows that FinTech players can put themselves in a stronger position by engaging in mutually beneficial collaboration rather than outright competition.

### **Non-financial core companies**

The third category of players is non-financial core companies. This category includes well-known retail companies like Gome and Suning. These players have an advantageous position in the value chain with their existing strong networks allowing them to access a large amount of offline data. Further, there is less activity by internet attackers and traditional financial institutions in this sector.

With these advantages, non-financial core companies can offer FinTech products and services to both their customers (business-to-consumer) and SME suppliers and distributors (business-to-business). Despite being a crucial part of the Chinese economy, SMEs were one of the groups that were previously underserved by traditional financial institutions.

### **Opportunities and innovations**

In a growing market, there are many opportunities for the various players, including in the most competitive, developed, and innovative segments, such as third party payments and the business-to-consumer end of the industry. However, FinTech is also expanding into other segments and niche sub-segments, and it is in these segments where there will be the most opportunities in the future. For example, non-financial core companies are active in the business-to-business segment, while some companies are getting involved in niche sub-segments like offering loans for cosmetic surgery.

As well as there being opportunities for FinTech players, there are also opportunities for companies that are not usually viewed as being inside the industry. Given the importance of the collection and analysis of big data to the industry, there are opportunities for data analytic companies to collaborate with FinTech players that do not have the capability to do this by themselves.

There are also many ways that **artificial intelligence (AI)** companies can collaborate with FinTech players. For instance, AI can be used in FinTech by eliminating or reducing face-to-face interaction, which will help reduce transaction costs. Baidu's stock trading app, StockMaster, already uses AI to predict share price changes.

## Challenges ahead

Although there are many opportunities in China's Fintech industry, most of the activities in the industry have been by domestic investors. One of the main reasons for this is because of government restrictions on foreign investors.

PayPal was not able to secure a license for domestic payments, and foreign investors were excluded from fundraising for Tencent's WeBank. Even where foreign investors have invested in the domestic market, they have faced cultural differences. Apple Pay's success has been limited because unlike its Chinese competitors, it has not been integrated into important platforms such as WeChat.

It is likely that in the long run the government will ease some of the restrictions on foreign investors so that China and its domestic players can benefit from foreign innovations, capabilities, and expertise. In the meantime, one of the ways foreign companies can benefit from China's thirst for FinTech is by being active in overseas markets, including in overseas markets where Chinese consumers are increasing their spending and investments.

Although the big Chinese players like the BAT giants are trying to internationalize, it is hard for them to replicate their domestic success and easier for foreign companies to compete against them. While foreign companies have a competitive advantage in overseas markets, they may decide that it is still better to collaborate with Chinese FinTech players.

Another important challenge that investors face is changes to the regulatory environment. Previously, loose regulations provided the industry with opportunities and was one of the reasons why the FinTech industry developed so rapidly in China. However, Chinese regulatory authorities are increasing their regulatory role to ensure that the industry develops more healthily.

The need for an increased regulatory role was highlighted by fraud cases, such as the E'Zubao peer-to-peer (P2P) lending scheme, a **Ponzi scheme** which had nearly one million victims and was subsequently closed in 2016. As recently as September, the government's concerns about initial coin offerings (ICOs), a disruptive technology, led the government to banning them.

These increased regulations are likely to have a significant impact on players in the industry, more so because the industry is developing so rapidly and there is uncertainty about what this increased regulatory role will look like exactly. Investors involved in FinTech will therefore have to take this into consideration when investing in the industry.

Until now, it has been possible for players in the rapidly expanding FinTech industry to succeed by following the innovations of other players. Although there are still many opportunities for growth in the industry, the introduction of a regulatory framework and fiercer competition will likely lead to a period of consolidation. The players that emerge on the top will be the leaders who are able to make the most of the opportunities through innovation and skilfully navigating challenges and regulatory uncertainty.

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