

# Study on Rural Finance Against the Background of Internet Finance in China

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## ABSTRACT

Rural finance has been considered an important element to rural development in China, yet the existing system of Chinese rural finance has been undeveloped. This situation can be greatly improved with the help of Internet finance which has been thriving in China in recent years. This paper focuses on the development of rural finance in China against the background of Internet finance. Firstly, it presents the defects of current rural finance markets from two angles, one of which is inadequate financial supply, and the other is unmet financial needs. Secondly, it explores Internet finance's effects on improving the efficiency of rural finance services. Finally, effective suggestions are made based on the analysis in order to gain the maximized benefits from Internet Finance and strengthen China's rural financial system.

**Keywords:** Rural China, Internet finance, Rural finance.

## 1. INTRODUCTION

Rural economic development needs favorable support from rural finance. The status of Chinese rural finance markets, however, has indicated that the functions of rural finance failed to be fulfilled. Under the background of flourishing Internet technology, it seems that it would be a good idea to promote the healthy development of rural finance with the help of Internet finance. This research begins by discussing the bottleneck of rural finance in China which lies in the imbalance of rural credit structure. The existence of the gap between supply and demand well reflects this kind of imbalance. It then explains why Internet finance can help resolve the problems of the development of rural finance that have been identified, including broadening channels for financing, reducing transaction costs and lower credit risk. Subsequently, it provides recommendations to the contradictions and chances involved from a governmental level.

## 2. PROBLEMS

Because of the unbalanced supply and demand, China's financial market in the rural communities is immature. To be exact, the coverage of rural financial services fails to satisfy the needs for loans.

### 2.1 Defective System of Rural Financial Supply

#### 2.1.1 Imperfect System of Rural Financial Institutions

There are insufficient formal rural financial institutions in China. Not only the number of formal institutions is low, but also the types of which are not rich enough.

Rural China lacks formal financial intermediaries. According to the People's Bank of China, as of late 2018, the number of bank outlets owned by 10,000 people was only 1.31. In addition, at the end of June 2019, the number of rural credit cooperatives fell from 812 at the end of 2018 to 782. Not many financial institutions have widely branched out into the rural market. The types of financial institutions are also limited. Currently, there are mainly one single type (rural commercial bank). Agricultural banks in other agricultural policy finance and rural commercial finance are not much built in rural areas[1].

Uneven distribution of finance agencies should also be noticed. Institutions fail to cover the entire rural areas of the country. Some rural areas with geographical advantages have smooth and rapid

economic development and relatively good rural financial development, so that villagers can better enjoy the convenience of financial services[1]. In contrast, the quantity of financial agencies and service outlets are much less in those remote and deprived areas.

### *2.1.2 Inadequate Volume of Rural Credit*

Insufficient amount of loans is not only attributed to the insufficient finance institutions, but also a result of the fact that financial institutions are unwilling to provide credit to rural residents. In other words, the amount of credit sanctioned to the people by the agencies is inadequate.

Why financial institutions are reluctant to lend money? This has to do with the high transaction costs due to the serious information asymmetry and high levels of borrowing default risk.

Availability of information is an essential factor in finance, which affects the smooth running of business transactions. Asymmetric information, a kind of market failure, affecting financial activities in two primary ways: adverse selection and moral hazard. Adverse selection refers to a situation where one party with less information chooses the wrong participant that he or her should not have chosen, who has key information, while a moral hazard is where one party has an incentive to put his or her interests first irrespective of his or her responsibility for the interests of another[2].

The present Chinese rural financial market exhibits serious asymmetric information. This is because as for information acquisition, rural loan applicants usually have more information than rural financial institutions. Credit providers face many difficulties in obtaining complete information about borrowers. The information transmission and the traffic in rural China are poor. Rural households often live in areas with poor transport and communication infrastructure where it is particularly expensive for service providers to reach the clients. And it is also difficult for lenders to get and review the information they need about potential borrowers (credit history or salary level). Since such high information search costs are required, the whole costs that reduce the uncertainty of lending activities and the risk of default are high and make a transaction happen are high. Given this, finance institutions choose not to disburse their service to most rural borrowers who they do not know enough about.

The default risk in rural areas is relatively high. According to a survey by the People's Bank of China, at the end of 2007, the non-performing loan ratio of the county branch of Agricultural Development Bank is up to 27.8%. The risk of agricultural credit provision comes from the natural fragility of agricultural production. Farming is strongly influenced by the natural environment and sometimes not under the farmers' control. Seasonable variability, unfavorable weather, or pest occurrence can all pose severe threats to both the quality and quantity of agricultural goods and make it difficult for farmers to control output.

Lenders' lack of both ability and willingness to repay can also be an explanation for the high default risk. Generally, traditional financial institutions not only require borrowers to have the ability to obtain repayment cash flow through activities such as production and operation, but also require legal loan collateral, pledges or qualified guarantors[3]. However, rural credit clients lack qualified collateral as most of the assets owned by farmers do not meet attributes that collateral shall have such as salability, disposability, low transaction cost and durability[4]. Credit service providers' willingness to lend money to farmers is low as most rural residents are unsecured, having poor repayment capacity and lacking qualified guarantees. This partly explains the imbalance of credit structure where a relatively large proportion of financial resources is unreasonably dispensed to comparatively well-to-do farmers. Those needy farmers (individual small and marginal farmers) that produce a small portion of goods are often viewed as unattractive clientele and financial resources fail to reach them.

Credit lenders' unwillingness also has to do with people's weak credit awareness. Rural clients usually have low education and poor literacy, so there is a general lack of treaty awareness among rural households, which means they do not think it is necessary to repay credit.

## *2.2 Unfulfilled Rural Financial Demand*

The rural financial markets not functioning properly is also related to the diversification of rural service demand. There is an increase in capital needs. The increasing demand for credit is not confined to agriculture purposes and can be seen in non-agriculture activities such as housing, medical care and children's education.

The financial support from the credit supply side, however, is incomplete and fails to offer responsive financial services. Right now, the main service provided is agricultural credit. The single service cannot respond to farmers' demand for capital for other purposes than other than agricultural production.

### **3. COUNTERMEASURES: RURAL INTERNET FINANCE**

Internet finance, a new kind of finance format, is booming in recent years. Known as low cost, wide coverage and high efficiency, it considerably increases the accessibility of financial market and can expand lending to more Chinese individuals as well as micro and small enterprises. It can be recognized as a key tool in the rural finance.

#### ***3.1 Broadening Access to Financing and Giving a Broader Range of Services***

One major type of online finance is ecommerce platform. It has a low threshold and unlimited use of loans by clients and can provide financing to low-income crowds or clients who previously stood no chance of obtaining loans.

One of the examples of the e-commerce platform is ant financial, an affiliate of China's Ali group, providing microloans to small business and individual entrepreneurs over the internet. Ant credit evaluates potential borrowers' creditworthiness based on transactional and behavioral data, such as timely delivery of products and settling of bills, which are collected as they do business online.

Ant financial subsidiary set up its own credit evaluation and scoring model based on online activities, gathering information and understanding client behaviors and characteristics, with the help of big data technologies and cloud computing services.

#### ***3.2 Great Convenience and Heightened Efficiency***

Internet finance's lending efficiency is considerably higher than the traditional approach to rural finance. Alibaba, with a team of 400 people, completed 1.1 million loans in the first quarter of 2013, with 2750 loans per capita. By contrast, a 2000 people loan team of Baoshang bank complete 57,000 loans over the same period, with 28.5 loans per capita[5]. Online finance has simplified and streamlined credit formalities. Loan applicants can

either approve or deny instantly; the lending services are 24-hour open; the loans processes, from sending applications, to receiving the funds, are typically fulfilled within a few weeks or less.

Apart from the simple and quick credit procedure, there are low costs. The operational costs for a virtual store are far less than their brick-and-mortar counterparts as there is no need to spend additional costs, such as rents, electricity bills and water bills, involved in running and maintaining a physical store.

Internet-based financing also has its advantages in reducing transaction costs as it can adjust market information asymmetry. Online finance service providers are efficient in information collection, using Internet technology such as big data and cloud computation in financial activities, which allows them to collect, integrate and store rich customer information at a fast pace and in an accurate way.

Traditional financial suppliers have passive access to information: they are required to dig deeply into enterprises that need financing to obtain information and rely on manual information collection and risk control judgment[6]. On the other hand, internet finance is more initiative in information gaining. It obtains all kinds of user information through the collection, classification and processing of big data. The information it gets contains normal business data, financial statements, logistics transactions and other information, which can be actively obtained through internet and can be more positive in the credit rating and evaluation of repayment ability[6].

Borrowers also benefit from this optimized online loan process for the reason that it can reduce their search costs. They can be provided with more information and get real-time updates.

### **4. POLICY RECOMMENDATIONS**

In response to the above situation discussed, the following suggestions to the rural finance challenges and opportunities are aimed to reform rural finance and improve access to credit by rural clients in the vast rural areas in China.

#### ***4.1 Establishing a Sound and Competitive Rural Financial System and Broadening Service Channels***

The government should devote itself to establish and develop a diversified and rational

rural financial credit system combining with both online and offline structures.

For the traditional finance sector, increase the types of institutions, including policy banks, commercial banks, rural cooperative banks and credit cooperatives. New kinds of rural financial institutions should also be encouraged. In the meanwhile, service outlets should be penetrated the remote and less developed locations to aid low-income populations and expand the financial service network to the whole rural areas.

Also, when introducing internet finance and both models infiltrate into rural areas, many rural residents would no longer select loans from banks or rural credit cooperatives as it would be much easier to get a loan online. So those physical suppliers would try to reform themselves and improve their efficiency for fear of being overtaken by their online counterparts. The advantages of both models can be maximized by the competition as well as cooperation between online and traditional finance.

#### ***4.2 Establishing and Improving the Rural Credit System***

A well-rounded rural credit platform can mitigate the information asymmetry problem. Databases can be set up to collect rural economic subjects' credit data, including business and individual credit, covering multiple aspects of information such as users' basic information, real estate mortgage and production and operation status. This system should be multifunctional, gathering and analyzing users' past track records with credit, giving credit references, producing credit files and credit ranks. Meanwhile, sharing information should also be encouraged among different financial institutions to ensure an adequate flow of credit information. And people with good credit can be rewarded with credit increases or loan amount increases.

#### ***4.3 Building the Risk Control Mechanism***

Online financing has its risks. Apart from the intrinsic systematic risk of online activities itself, appearing in the forms of operation risk or technological risk, there are financial crimes on the internet. According to the "2019 network fraud trend research report" launched by 360 Enterprise Security Group and 360 Orion platform, in 2019, financial fraud had become the primary type of reported fraud with both its number of reports

(3314) and per capita losses (53.265 yuan) the highest.

The online financial risk entails a complete risk prevention and avoidance system as well as a safer credit transaction environment. Firstly, it ensures the safety of user personal information. Secondly, it enlarges information disclosure. Finally, it strengthens the construction of supervising and managing the online system.

#### ***4.4 Laying Emphasis on the Rural Financial Personnel Training and Education***

In order to effectively improve the quality of online financing credit services, government should build a team of qualified people to meet the needs of rural online finance development. Governments should allocate a certain amount of funds to the discovery, selection and training of financial talents, cooperate with colleges and universities to encourage students to study rural online finance, offer vocational training to prepare them for a career in this area, and assess regularly network financial personnel's skills in handing professional business knowledge.

### **5. CONCLUSION**

The focus of this paper is the role of Internet finance in rural financial development. To sum up, the rural financial service system in China is unsuccessful in serving the financial needs, and has a long way to go to reach a supply and demand balance. The rapid development of the Internet, to some degree provides a solution to this challenge. Attempts at reform are required to conduct to build a comprehensive and competitive rural financial market. First, the government should establish a multi-level rural financial service system. Second, the construction of a credit system in the rural society should be carried out. Third, rural financial risk-sharing and compensation mechanism should be constructed. Forth, the education of Internet rural finance professionals should be paid stress on. These suggestions are supposed to have some values in resolving the problems identified and promoting financial sector development in rural China.

### **AUTHORS' CONTRIBUTIONS**

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