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China Fintech Report 2020

China takes its fintech prowess to the world stage

October 2020

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EXECUTIVE SUMMARY

China leads the world in adoption of financial technology (fintech). The ubiquity of mobile payments introduced by the country's tech giants paved the way to launch a host of other financial offerings through their all-encompassing lifestyle platforms. And Chinese consumers, who are many times more likely to be early adopters of new technology in financial services than those in any other major global market, have lapped them up. The biggest driving force of the adoption of fintech is the pervasiveness of smartphones in China, where roughly one in every two of the 1.6 billion mobile phones in the world's largest communication market is a device capable of data and internet services. Other major contributing factors include steadily rising incomes and the still significant scope to broaden access to credit, wealth management and insurance products.

China led the world in investment in fintech start-ups in 2018, though deal activity declined sharply in 2019 for a variety of reasons including a slowing economy and mounting US-China trade and political tensions. But the drop was not entirely unexpected given that venture capital investments are cyclical, with periods of intense activity naturally followed by declines.

Following the initial public offerings of several prominent Chinese fintech over the past two years, funding is increasingly shifting to public markets. Overall investor interest in the sector appears to be on an upswing, especially in light of the Covid-19 pandemic, which has resulted in greater demand for technologies lessening face-to-face interaction.

Tech giants dominate

The majority of prominent fintech start-ups in China are incubated by one of the country's technology giants, including Alibaba Group Holding, Ant Group, Tencent Holdings, Baidu, JD.com and Ping An (an insurance giant that has emerged as a major tech player). These companies have become heavily involved in finance without assuming much financial risk themselves, instead partnering with established financial institutions and earning fees from providing access to technology as well as their massive user bases.

The tech giants are behind the country's four licenced digital-only banks, including Tencent-founded WeBank, Alibaba-backed MYBank, Baidu's aiBank and Xiaomi's XWBank. They account for only a negligible portion of the country's banking assets, owing in part to their deliberate "asset-light" strategies. But they have made great strides in promoting overall economic development with their focus on getting micro loans to consumers and credit to SMEs, whom the established banking sector had long neglected.

The digital-only banks are able to do this by employing artificial intelligence technology to analyse the troves of user data they have access to through their backers' wider ecosystems to assess the creditworthiness of millions of individuals and businesses who otherwise lack credit histories. This method could arguably even lead to a more stable financial sector, with the country's digital-only banks recording significantly lower default rates than the established banks.

Broadening financial inclusion

Technology has also been a powerful force in democratising wealth and asset management in China, allowing millions of ordinary people to invest in assets previously available only to the affluent. Most recently, tech giants have begun to offer sophisticated fee-based investment advice to the masses, charging users a nominal fee to apply AI-powered algorithms to guide them in choosing the most appropriate mutual funds based on their investment goals.

In the insurance field, massive online platforms serve to connect hundreds of millions of users with appropriate policies. Data analytics is used to innovate new products that were previously not feasible, such as medical insurance for people aged 60 to 80. China has also pioneered a new model of insurance in the form of mutual aid platforms, which pool small contributions from millions of participants and pay out on verified illness claims of participating members. Users can access mutual aid plans at a fraction of the cost of regular health insurance, and although the platforms are not profitable for the operators, they can be valuable drivers of traffic to their other offerings.

A vision for blockchain

China is also seeking to lead the world in blockchain development and deployment. President Xi Jinping proclaimed in October 2019 that he wanted China to "seize the opportunity" to become a "rule maker" in the field. He added that the technology had clear potential to transform the country's major industries, and suggested it would be a vital focus area in its race against the US for technological supremacy.

In line with Xi's vision, China is also seeking to establish the world's first central-bank issued digital currency. But the country's nascent sovereign digital currency is unlikely to unseat the dominant mobile payment platforms, Alipay and WeChat Pay. The "stickiness" of those platforms and their wide-ranging lifestyle offerings will see them endure despite the advantages of a government-backed digital currency.

Regulatory shift

Until recently, Chinese fintechs have grown without much regulatory interference. But it appears the tide may now be turning with the emergence of a more hands-on regulatory approach seeking healthy market development and better risk management. That change – the regulation framework catching up – is perhaps in the best interests of the sector's sustained development, as it will help to rein in systemic risk and prevent reputational damage that could result from failures such as the recent high-profile collapse of the country's peer-to-peer lending industry.

And regulatory pressure on China's tech giants could well turn into opportunity, by encouraging partnerships between fintechs and established financial institutions and a shift in the relationship between the two from competition to collaboration.

Growth potential

China's fintech giants have plenty of room to increase revenue at home, with rising incomes feeding steady growth over the coming years in the country's personal investable assets, insurance premiums and consumer and business credit segments. There is also room to grow internationally, as China seeks to export its developing fintech prowess. The most compelling export markets for Chinese fintech are developing countries, where the need for greater financial inclusion is most pressing.

Perhaps the biggest lesson to be gleaned from China's fintech journey is that partnering to create wide-ranging ecosystems can create immense value. Both Tencent and Alibaba have established partnerships with third parties across virtually every major industry, from retail and transport to healthcare and finance.

The lesson for established financial institutions is that striking partnerships both within and outside the financial realm will be crucial to creating value for customers and competing with technology companies eyeing a move into financial services. The lesson for fintechs is that the Chinese model could become the norm globally, as reflected by the growing number of start-ups around the world focused on providing technology to incumbent banks, insurers and asset managers, rather than seeking to disrupt them.

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FIGURE 9: PROMINENT START-UPS ACROSS MAJOR FINTECH SEGMENTS

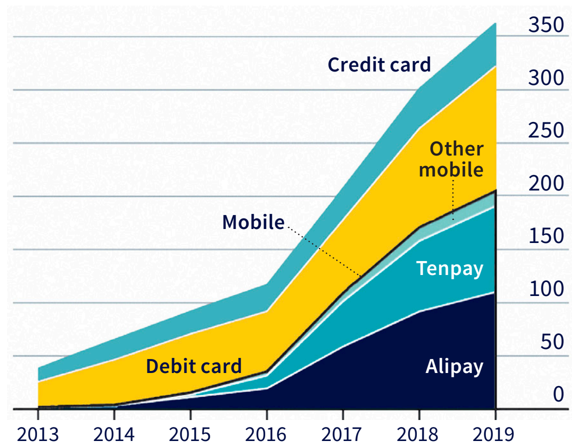
Source: Goldman Sachs analysis

2.1: DIGITAL PAYMENTS

As the first country to use paper currency,[2] it is perhaps fitting that China is now a leading contender to become the world's first cashless society. That shift will be very much mobile-first, with mobile payments accounting for four out of every five payments in the country and more than half the value of all non-cash retail payments (see figure 10).[3]

In 2011, China's mobile payments barely registered. By March 2020, some 776 million people in China used mobile payment services, making purchases and sending cash digitally, with the vast majority using either Alipay or WeChat Pay.[4] Shopping festivals like

FIGURE 10: CHINA NON-CASH RETAIL PAYMENTS *(TRILLION YUAN)*



Source: Analysys, People's Bank of China, The Economist

[2] The first known examples of paper currency as we would understand it today were created in China during the Song Dynasty (AD 960-1297): Guinness World Records: https://www.guinnessworldrecords.com/world-records/first-paper-money

[3] Robert Hackett, "Inside China's drive for digital currency dominance", Fortune, 10th August, 2020: https://fortune.com/2020/08/10/china-digital-currency-electronic-yuan-bitcoin-cryptocurrency/#:~:text=China%20is%20further%20along%20than,that%20underlie%20cryptocurrencies%20like%20Bitcoin

[4] Statistics released in March 2020 by People's Bank of China: http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3990502/index.html

Singles' Day in November will help Alipay obtain more share in the fourth quarter, while WeChat Pay always has a better performance in the first quarter when people use WeChat for red packets to give away money during Chinese New Year. And although the respective market shares of Alipay and WeChat Pay are expected to remain stable in the foreseeable future, competition will remain fierce. Going forward, the focus of that competition will shift from consumers to 2B, or services to businesses.[5]

FIGURE 11: CHINESE POPULATION WITHOUT CREDIT CARDS

Source: Oliver Wyman analysis. At the end of 2019.

The rise of mobile payments

The popular explanation for the rise of mobile payments in China is that they arose in response to pent-up demand in a market with underdeveloped payments infrastructure and low credit card penetration.[6] Although incomes surged over the past two decades on the back of the country's strong and steady economic growth, spending growth was curtailed by the above structural problems in China's financial sector. The state-owned banks were slow to respond, paving the way for technology firms to fill the gap and fuel the country's consumption boom.

Yet this is not really the simplest explanation. It is more likely that the primary intention of Alibaba and Tencent in offering mobile payments through their apps was to serve their respective ecosystems rather than to disrupt the financial sector. For Alibaba, it was a way to facilitate e-commerce transactions on its platform, and for Tencent, whose main offerings are a social network with a suite of gaming products, the launch of a peer-to-peer payments service was intended to build brand stickiness (see case study on "The Rise of WeChat Pay"). Mobile payments deepened engagement across their massive userbases, becoming the backbone to develop wider fintech ecosystems through the cross-selling of a range of financial products and services (see figure 12).[7]

The Alipay and WeChat Pay ecosystems also feature an immense range of lifestyle offerings that keeps users inside the apps. The Alipay platform currently hosts over two million mini programmes discoverable by users through the in-app search or

FIGURE 12: TENCENT AND ANT GROUP'S FINTECH ECOSYSTEMS

Source: World Economic Forum

[5] Celia Chen, "China's mobile payments to see rebound as offline vendors reopen after coronavirus lockdowns ", South China Morning Post, 2nd April, 2020: https://www.scmp.com/tech/apps-social/article/3077941/chinas-mobile-payments-see-rebound-offline-vendors-reopen-after

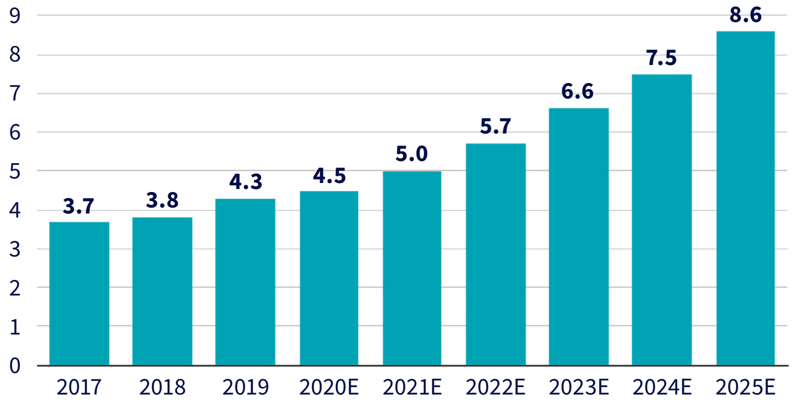
[6] Emily Conrad, "The Great Unbanked", The World of Chinese, 12th January, 2019: https://www.theworldofchinese.com/2019/01/the-great-unbanked/

[7] World Economic Forum: "Innovation in Payments and Fintech: A comparison of the Chinese and Indian ecosystems", May 2020: http://www3.weforum.org/docs/WEF_Innovation_in_Payments_and_Fintech_China_India_ENG_2020.pdf

2.4: INSURTECH

Insurance technology (insurtech) provides a strategic advantage in the provision of insurance, through greater efficiency and improved customer experience. Insurtech in China has enabled the purchase of policies at lower rates with a click of a button and the dramatic widening of critical illness coverage through the new model of mutual aid platforms. And of course, the potential for insurtech in China is huge, with the country tipped to overtake the US to become the world's biggest insurance market before the mid-2030s.[70]

FIGURE 21: CHINA INSURANCE PREMIUMS *(TRILLION YUAN)*



Source: Oliver Wyman analysis

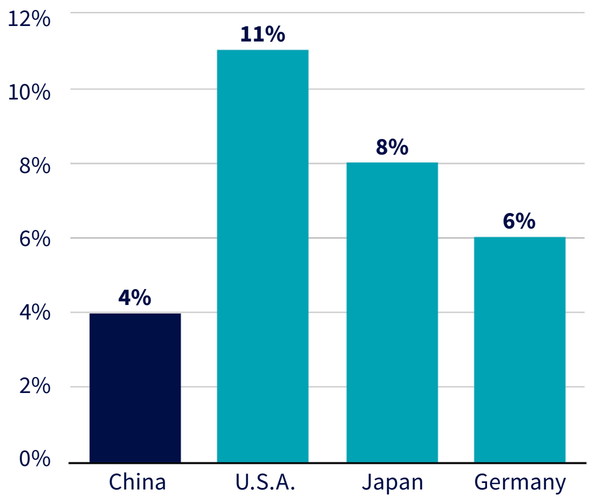
Zhong An leads the charge

China's first online-only insurance company was Zhong An Online P&C Insurance Company, co-founded in 2013 by Alibaba, Tencent and China's largest insurer, Ping An Group. Not only was it a purely digital company, but was also the country's first insurance company to sell its products over the internet.[71] Zhong An listed on Hong Kong's stock exchange in 2017, becoming the city's largest IPO that year. Although it has yet to record a profit since listing, it has greatly expanded its business while narrowing losses, having served 486 million users and underwritten more than 8 billion policies.[72]

Zhong An views insurance as a "data game", with data providing insights to generate tailor-made solutions for customers. It also works with a wide range of ecosystem partners to serve a variety of unmet needs. Zhong An provides cracked screen insurance to customers when they buy a phone on Xiaomi's website, flight delay insurance on Ctrip, China's largest online travel agency, and its top-selling product, shipping return insurance offered on Alibaba's Taobao. And its ultimate vision for insurtech is to gather data from a multitude of sensors on 5G networks to offer tailored, situational micro-policies at every step of the customer journey.[73]

Zhong An made a name for itself by offering several novel insurance products not available in other markets. When it launched in 2014, it offered

FIGURE 22: INSURANCE PENETRATION BY COUNTRY (TOTAL PREMIUMS AS PER CENT OF GDP, 2019)



Source: Oliver Wyman analysis

[70] Joanna Lam, "China will become world's biggest insurance market by mid-2030s, speeding past US on the way, says analyst", South China Morning Post, 7th March, 2019: https://www.scmp.com/business/article/2189033/china-will-become-worlds-biggest-insurance-market-mid-2030s-speeding-past

[71] Accenture, "What can insurers learn from Chinese insurtech giant Zhong An?", 15th January, 2019: https://insuranceblog.accenture.com/what-can-insurers-learn-from-chinese-insurtech-giant-zhong-an

[72] Zhong An Online P&C Insurance Co 2019 annual report: https://www1.hkexnews.hk/listedco/listconews/sehk/2020/0323/2020032300436.pdf

[73] Sareena Dayaram-Gupta, "How Baidu, Alibaba, and Tencent plan to dominate Chinese online insurance", Tech in Asia, 25th October, 2017: https://www.techinasia.com/baidu-alibaba-tencent-dominate-chinas-online-insurance-market

"binge drinking" insurance, paid out if football fans watching the World Cup needed medical attention after excessive alcohol consumption. Another of its policies, called "high heat" insurance, reimbursed customers when the temperature reached 37°C. However, Zhong An and other online insurance groups have stopped selling many such products after Chinese regulators sought to ban them.[74]

Platform advantage

Given the critical advantage conferred by access to data, perhaps the biggest risk faced by Zhong An is competition from its own backers. Both Ant and Tencent sell insurance through their platforms, while Ping An, already the country's largest insurer by market capitalisation, has wholeheartedly embraced technology and innovation, having announced a 20 per cent increase in its budgeted investment in technology for 2020 to 12 billion yuan. Ping An said its increased technology investment is aimed at boosting cross-selling between its different business lines, such as insurance, healthcare and fintech provided by its OneConnect subsidiary.[75]

Ping An has already made good use of technology to improve its operations. For instance, by linking its customer databases and core claim management platforms with its AI risk management system through the cloud, it has created an intelligent motor insurance claims-handling system that can settle claims online in under three minutes, with chatbots capable of handling 97 per cent of customer queries.[76]

Ant revealed in its listing prospectus that it is now the country's largest online insurance services platform, covering life, health and P&C (property and casualty) insurance. Ant offers these policies through 90 partner insurance institutions, receiving commissions on the premiums they sell on its platform. Moreover, Ant claims to leverage technology and its customer insights to "jointly design" innovative products with its partners and to improve all stages of the process, including the detection of fraudulent claims.

Despite the myriad advantages of selling insurance on the massive ecosystems of China's tech giants, online insurance premiums were still estimated to account for less than 8 per cent of total Chinese insurance premiums in 2019, suggesting they have a long way to grow.

And of course, Ant's relationship with the wider Alibaba ecosystem allows it to market personalised insurance offers to hundreds of millions of customers. For example, observing that a customer on Alibaba's popular Tmall marketplace had bought a cot, stroller and infant formula, it could deduce they are expecting a child and propose tailor-made insurance products for them.[77]

The rise of mutual aid platforms

Despite the myriad advantages of selling insurance on the massive ecosystems of China's tech giants, online insurance premiums were still estimated to account for less than 8 per cent of total Chinese insurance premiums in 2019, suggesting they have a long way to grow. They are forecast to increase at a compound annual rate of 38 per cent until 2025, when they will reach an estimated 1.9 trillion yuan. At the same time, China will see strong growth in a unique model of insurance through so-called mutual aid platforms.

China's tech giants, including Ant Group, Baidu, on-demand delivery company Meituan Dianping, ride-hailing operator Didi Chuxing and smartphone maker Xiaomi, all now offer affordable healthcare plans via

[73] Don Weinland, "Chinese online insurer ZhongAn raises $1.5bn in IPO", Financial Times, 22nd September, 2017: https://www.ft.com/content/424e7b36-9f5d-11e7-9a86-4d5a475ba4c5

[74] Enoch Yiu, "Chinese giant Ping An earmarks US$1.7 billion for technology that will bring its insurance, health care businesses together", South China Morning Post, 4th March, 2020: https://www.scmp.com/business/banking-finance/article/3064658/chinese-giant-ping-earmarks-us17-billion-technology-will

[75] Fintech News Hong Kong, "Understanding What's Behind China's Booming Insurtech Scene", 4th November, 2019: https://fintechnews.hk/10347/insurtech/china-insurtech/

[76] Erika Krizsan, "Insuretech boosts China's online insurance market, Insurance Factory, 26th May, 2020: https://insurance-factory.eu/insuretech-boosts-chinas-online-insurance-market/

[77] Jang Zhang, "Online mutual aid platforms are plugging a health care gap in China for those on lower incomes", South China Morning Post, 27th June, 2020: https://www.scmp.com/tech/big-tech/article/3090759/online-mutual-aid-platforms-are-plugging-health-care-gap-china-those

3.3: EXPANDING OVERSEAS

Fintech in China has been a major force for good, helping to significantly broaden financial inclusion. Yet much still needs to be done. While the share of the Chinese population with a bank account has risen from 64 per cent in 2011 to 79 per cent by 2019, that still translates to hundreds of millions of people without accounts.[19] So clearly, there is plenty of fintech growth potential at home.

But in their ceaseless search for growth opportunities, China's fintech giants are also seeking to export their capabilities. Since 2016, Ant Group has set its sights on increasing its international reach. Alipay has partners spanning Asia, including Thailand's TrueMoney, Cambodia's DaraPay and India's Paytm. OneConnect started expanding in Southeast Asia from 2018, including Singapore, Indonesia, the Philippines and Thailand.[20] And Tencent and JD.com have also clinched several high-profile fintech partnerships and acquisitions throughout the region.[21]

In less developed Southeast Asian markets, such as Indonesia and the Philippines,[22] as many of two-thirds of adults still don't have bank accounts.[23] Considering internet penetration stands at over 60 per cent among the population aged 15 or older in Indonesia[24] and close to 90 per cent in the Philippines,[25] the path to bridging that gap is clear. The region is therefore set to spawn significant opportunity in the coming years, including the licensing of digital-only banks, which has already taken place in China, Singapore, South Korea and Malaysia.

> Perhaps the biggest opportunity internationally is for China's fintechs to collaborate with traditional financial institutions, providing them with the tools necessary to compete in the new economy.

But perhaps the biggest opportunity internationally is for China's fintechs to collaborate with traditional financial institutions, providing them with the tools necessary to compete in the new economy. Asian financial institutions looking for fintech solutions know that China's offerings have been tried and tested in the largest market in the world.

China's fintech providers could also stand to benefit from the country's ambitious Belt and Road Initiative, which counts among its goals the promotion of cooperation among countries and regions in various areas, including facilitating unimpeded trade and financial integration. Technology could provide a vital tool in achieving those goals, and Chinese firms stand ready to supply them.

Upcoming international moves

Following its upcoming IPO, Ant Group is expected to continue expanding its international reach, as will the country's other major fintech players (see figure 14). In 2019, Ant submitted an application for a digital banking licence in Singapore, while Tencent made a number of significant investments in fintech companies overseas, including Ualá in Argentina.[26]

[19] Huang Yiping, "This is how digital banking could boost China's economy", World Economic Forum, 17th February, 2020: https://www.weforum.org/agenda/2020/02/china-digital-revolution-bank-lending-finance-economy

[20] Yang Han, "Nation's fintech companies expand their reach", China Daily, 15th June, 2020: https://global.chinadaily.com.cn/a/202006/15/WS5ee6cd37a310834817252f4f_1.html

[21] Chiara Rossolini, "China Exports Fintech: 5 Countries Where it Has Been Successful", Cifnews, 11th April, 2019: https://en.cifnews.com/china-exports-fintech-5-countries-where-it-has-been-successful/

[22] https://www.scmp.com/business/banking-finance/article/2149989/chinas-fintech-companies-are-exporting-ai-and-big-data

[23] https://asianbankingandfinance.net/retail-banking/news/chart-week-check-out-which-countries-have-largest-unbanked-populations

[24] https://jakartaglobe.id/context/indonesia-143m-internet-users-2017-apjii

[25] https://blogwatch.tv/2019/02/ph-takes-the-global-lead-in-time-spent-online-and-on-social-media/

[26] KPMG, "Chinese fintech attracted investments of USD 962.2 million in 2H 2019, 27th February, 2020: https://home.kpmg/cn/en/home/news-media/press-releases/2020/02/chinese-fintech-attracted-investments-of-usd-962-2-million-in-2h.html

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