CHINESE ACADEMY OF FINANCIAL INCLUSION

Diagnosis of the Epidemic's Impact on the Financial Health of the Working Class and the MSEs in China & Policy Recommendations

Background

The outbreak of COVID-19 has affected the life of hundreds of thousands of Chinese and might have a wider and long-lasting impact on the economy than SARS. The financial health of the already vulnerable wage-earners and the MSEs in China became our concern. Whether they have the capability and confidence to recover from the nationwide lockdown since January is the key to national economic recovery.

With the support of the related companies listed below, industry associations and the International Finance Corporation (IFC), the Chinese Academy of Financial Inclusion (CAFI) researched on the epidemic's impact on the financial health of the working class and the MSEs in China by collecting 2000 responses from different walks of life and communities.

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Methodology

- **1250** valid sample of MSEs and wage-earners
- **16** indicators across **4** dimensions
- A score ranging from **0** to **10** is assigned to each indicator, with **6** being the passing score and **10** the best one.

	Family Financial Health	Business Financial Health
Objective	1. Can you make ends meet 2. Do you have any overdue debt 3. Total debts over total assets ratio 4. Ability to raise emergency funds 5. Adequacy of Emergency Savings 6. Adequacy of Insurance 7. Current assets over monthly expenses ratio	1. Current Asset Turnover 2. Asset Turnover 3. Liability ratio 4. Adequacy of Emergency Funds 5. Ability to raise emergency funds 6. Does the company have any overdue debt
Subjective	1. The feasibility of financial plans 2. Resilience against financial shocks 3. Confidence in future family finances	1. The feasibility of financial plans 2. Resilience against financial shocks 3. Confidence in future corporate finances

Key Findings

1 Despite the inadequate cash savings and weak emergency preparedness, **the wage-earners and the MSEs had relatively low debt ratios** and **were generally confident about the future**.

2 According to the report**, the first 3 months after the epidemic broke out were critical to most of the businesses.**

65% of the owners said their business could only survive up to 3 months with their own money.

58% said the money they could borrow could sustain no more than 3 months of operation.

Among all the surveyed businesses**, 70% said they had financing needs after the outbreak struck**.

3 The **wage-earners** were weak in managing their finances and assets, but thanks to the wide coverage of social insurance, their risks remained well under control. they generally **stayed positive** about their future employment status.

Key Findings

4 **Online business showed its advantages during the crisis**:

32% pure online businesses were not affected, and **10% of them even experienced an increase of net profit.**

5 Digitization of business enabled higher accessibility to finance:

close to **50% of business preferred to borrow online from digital lenders**.

6 Based on the findings, it is recommended **to further improve the existing online lending regulation** (such as an increase of the upper limits for digital loans both in terms of amount and tenor, to adapt to the needs of the MSEs and enforce the regulation on non-bank FIs as soon as possible.

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01 Diagnosis of the MSEs

Definition

- The definition of MSEs used in this report includes the micro enterprises defined by the National Statistics Bureau, as well as individually-owned businesses (self-employers) that operate online and offline.

- Although the official definitions of micro-enterprises vary by industries per turnover, number of employees, etc., banks in China generally consider borrowers with loan amount up to USD 1.4 million (RMB 10M) MSMEs, below USD 713,878 (RMB 5M) as SMEs, and below USD 142,775 (RMB 1M) as micro-enterprises/ MSEs.

Surveyed SMEs by Sector

- More than **half** of the SMEs employ fewer than 3 employees
- Over **70%** of the SMEs hire fewer than 9 employees
- **60%** of the SMEs have monthly net income below 30,000 RMB (US$4,300)

Samples of SMEs

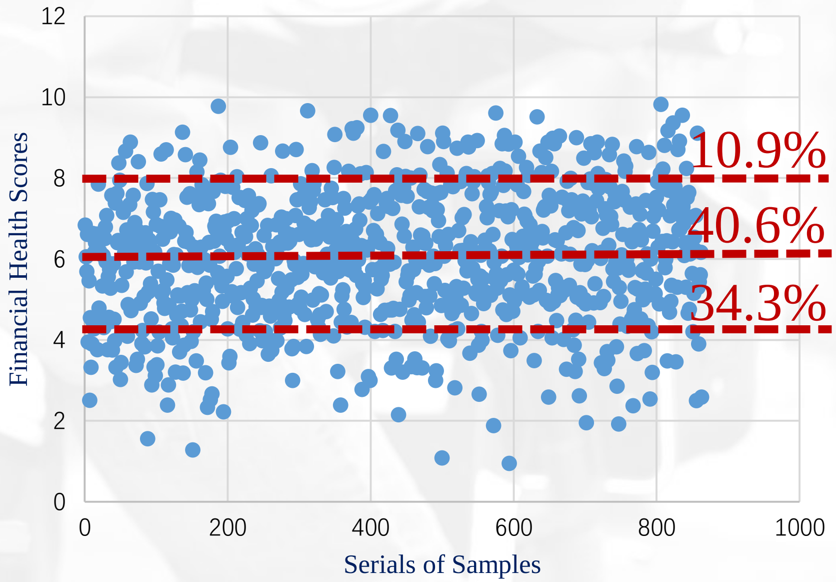
	Operating income (10,000 RMB)	Total Assets (10,000 RMB)	No of employees (people)	Sample size
Wholesale and retail	113	110	3	322
Agriculture, forestry, animal husbandry and fishery	70	97	3	195
Accommodation, catering, tourism and other lifestyle services	28	20	3	100
Information Technology Services Industry	81	102	8	55
Construction industry	80	45	5	54
Manufacturing industry	514	225	12	48
Transportation industry	17	20	1	38
Sports and Entertainment Industry	112	50	6	33
Other industries	4	3	2	9

Online Questionnaire Survey：Sample Size N=854, all SMEs　Online Interview with SME Owners：Sample Size N=10

Average financial health scores of the MSEs and score distribution

Snapshot of the results across 10 key dimensions

Scatter Graph on Financial Health Scoring



* Note: score 1-10, with 0 the lowest, 6 being the passing score and 10 the best one.

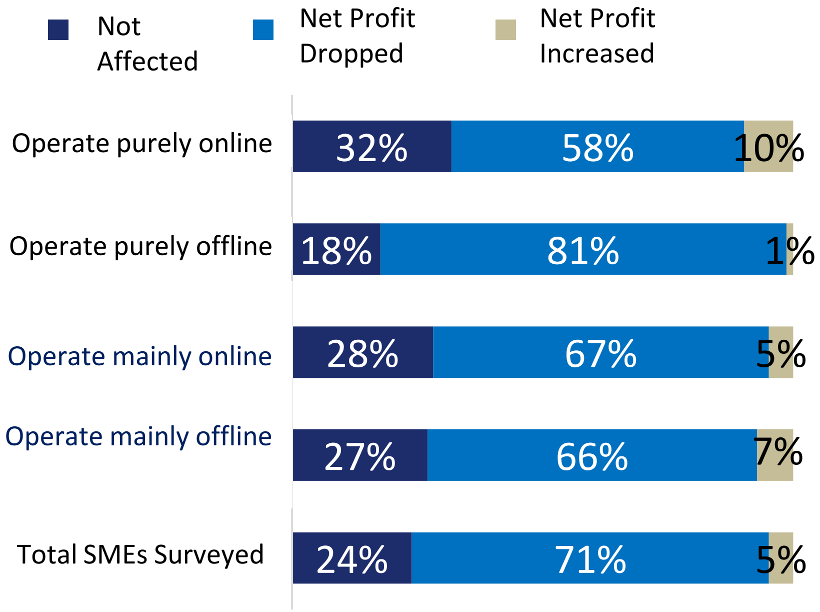
Diagnosis 1

Online operation showed its advantages during the outbreak and might play a dominant role in the future

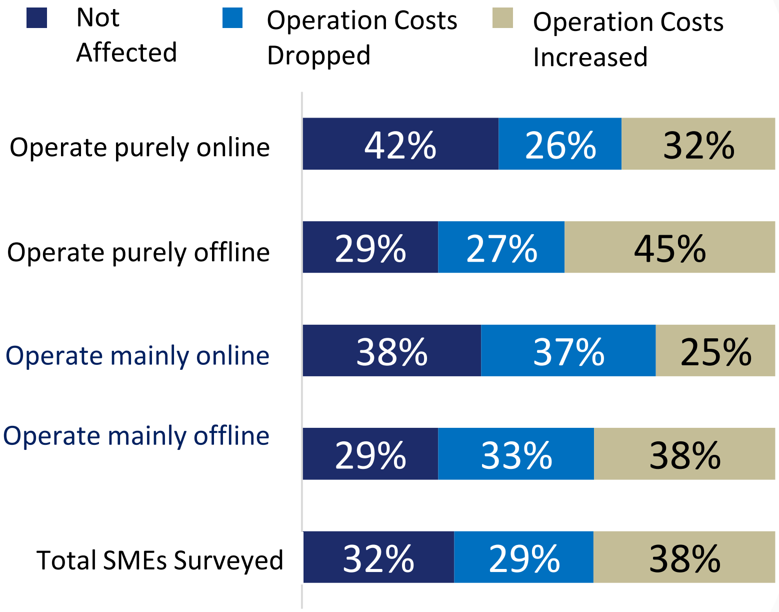
Most of the MSEs suffered from a reduction in net profit due to the epidemic, while pure online businesses took the smallest hit.

- **71%** of the business owners reported a year-on-year decrease in net profit
- Among all the pure online businesses, 32% were not affected in terms of net profit, while **10% saw increases**
- Regression analysis shows a **positive correlation between online operation and business financial health scores.**
- The epidemic acted as a stimulant for transition: **11%** of the offline businesses said they planned to move online in 3 months after the epidemic broke out.

Diagnosis 1 Online operation showed its advantages during the outbreak



The Epidemic's Impact on the SME's Net Profit



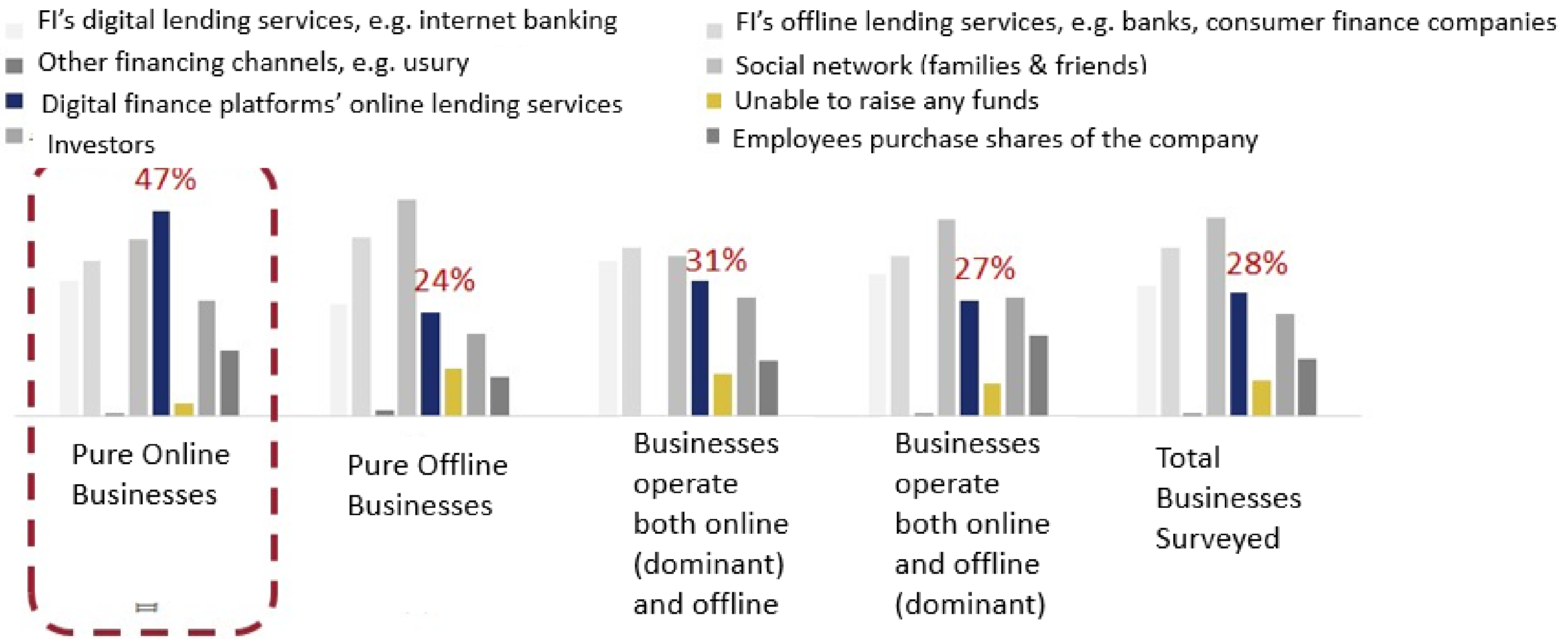
The Impact on the SME's Operation Costs

Diagnosis 2 Business digitization enabled higher accessibility to finance

Pure online businesses enjoyed higher accessibility to business loans, who were mainly served by digital finance platforms

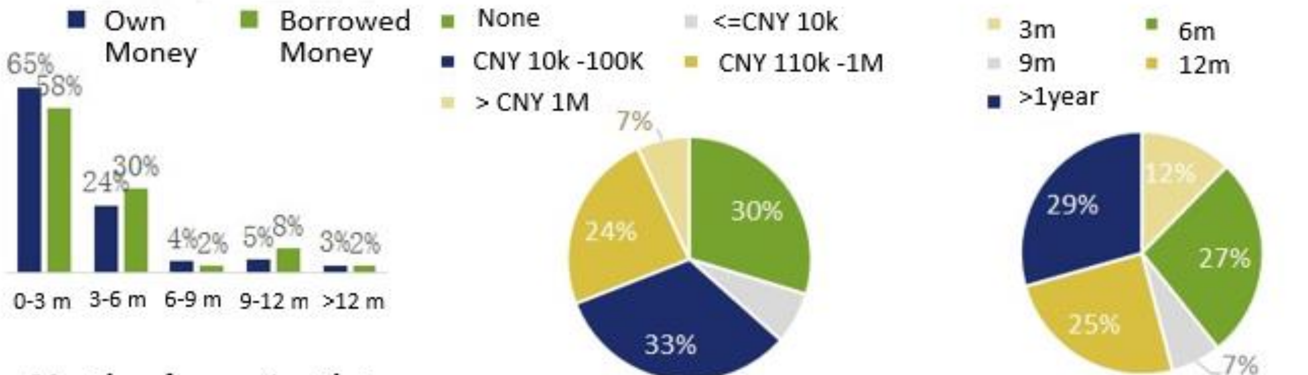
- Among all the pure online businesses, **47%** chose to get a loan from online platforms, while the ratio is **30%** in other business categories.
- The reason could be that pure online businesses have accumulated a lot of personal and corporate behavioral data online, which allows the digital lending platforms to achieve speedy credit assessment and approval

Diagnosis 2 Financing Channels for Different Types of Businesses



Diagnosis 3 High risk of business interruption and high demand for small mid- and long-term loans

- **The 3-month critical threshold: 65%** of the owners said their business could only survive up to 3 months with their own money; **58%** said the money they could borrow could sustain no more than 3 months of operation.
- The financing needs were in general less than CNY 1M (USD 142,692). Mid- and long-term loans with tenor above 1 year were most favored by the owners, who were concerned that the "due on demand" loan tenor might make them vulnerable to loan reduction or rescission.



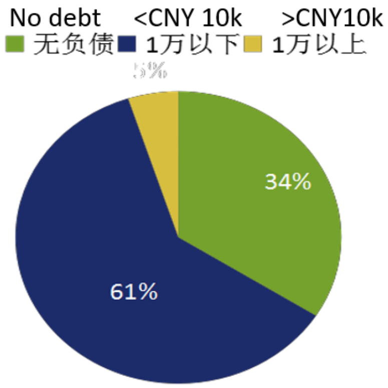
Months of operation that the money can support

Financing Needs

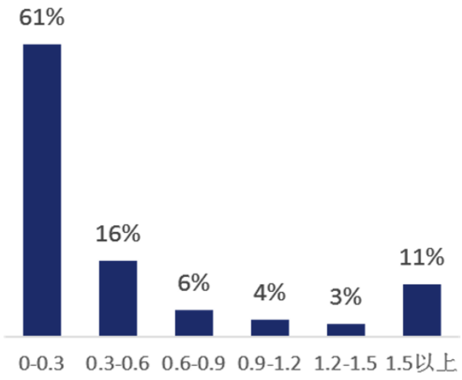
Loan Tenor Favored

Diagnosis 4 Strong solvency: maturity extensions will be of substantial help

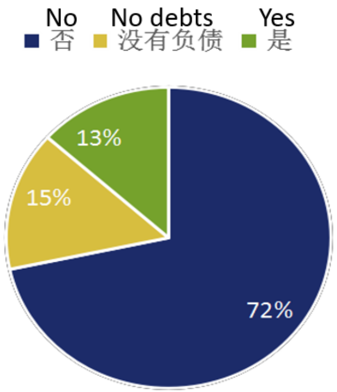
- The MSEs generally had a few liabilities and low liability ratios.
- Most of the MSEs had a clean credit history (only 13% with overdues), but 30% needed extension and 9% were unable to repay.



Total Liabilities



Liability Ratios



Overdue History

Diagnosis 5 Non-bank financial service providers were in a better position to serve the MSEs

- Digital and private lending services were more welcome by the MSEs despite higher interests costs.
- The MSEs were reluctant to borrow from banks due to the complicated process and limited flexibility on loan terms, also because they lacked the bank acceptable collaterals and/or standardized financial statements/reports that the banks required.

Diagnosis 6 Lack of awareness on risk response mechanism indicating huge market potential for inclusive insurance

- **46%** realized the importance of liquidity management having gone through the epidemic
- Only **21%** wanted to enhance their anti-risk capacity through purchasing insurance. A majority knew little about business insurance and thought their business was too small to be insured, which needed more cash instead.
- Potential for insurance products targeting MSEs are yet to be released, given the increasing awareness over the importance of insurance.

CAFI

Diagnosis 7

Fiscal policies have played a larger role than financial policies during the outbreak

- Preferential fiscal policies on tax, subsidies, rent reduction and social security have helped reduce the operation costs of the MSEs effectively.
- The study shows a positive correlation between loan increase, interest reduction and the financial health score, whereas a negative correlation was found between maturity extension and the score, which indicates that businesses with poorer financial health have a more urgent need for maturity extension.

45% | Enjoyed Tax Reduction

39% | Enjoyed Rent Reduction

31% | Enjoyed Maturity Extension

29% | Enjoyed Deferred Social Insurance Payment

Diagnosis 7

Fiscal policies have played a larger role than financial policies in short term

- Most of the surveyed businesses said the tax reduction and exemption policy had a positive impact on their operations.
- As to the financial policies, most of the businesses surveyed online said they looked forward the most to the actual implementation of the loan maturity extension policy and ease on the loan requirements for the MSEs.

45% | Enjoyed Tax Reduction

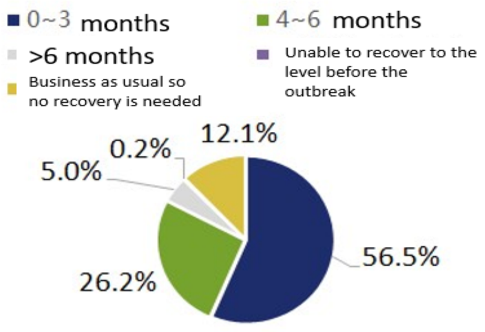
39% | Enjoyed Rent Reduction

31% | Enjoyed Maturity Extension

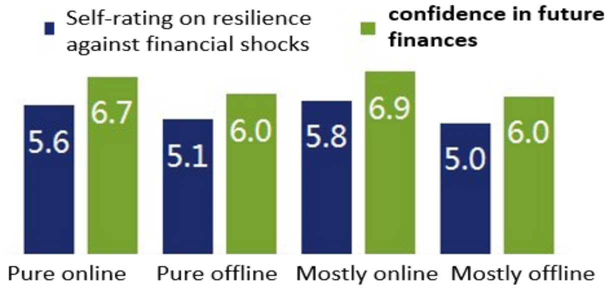
29% | Enjoyed Deferred Social Insurance Payment

Diagnosis 8 The epidemic's hit on the SME's confidence is not as devastated as we expected

- Most of the surveyed businesses said they could bring the business back on track in less than 3 months after the epidemic broke out.
- Thanks to the strong customer relationship and network created over the years, years of dedication to one sector, the new opportunities offered by a variety of digital tools and the hopes for a beautiful life ahead, the MSEs remained confident about their future finances.



The time needed for bringing business back on track



Resilience against financial shocks & confidence in future finances

Diagnosis 9 The Good financial behaviors are the key to securing financial health

It is discovered that good credit history, clear financial planning and adequate insurance coverage prior to the outbreak are the keys to secure the financial health of MSEs . On the other hand, med- and high-risk investments will put pressure on the businesses and harm their financial health.

Diagnosis 9 Correlation between good financial behaviors prior to the epidemic & the financial health score after the outbreak struck

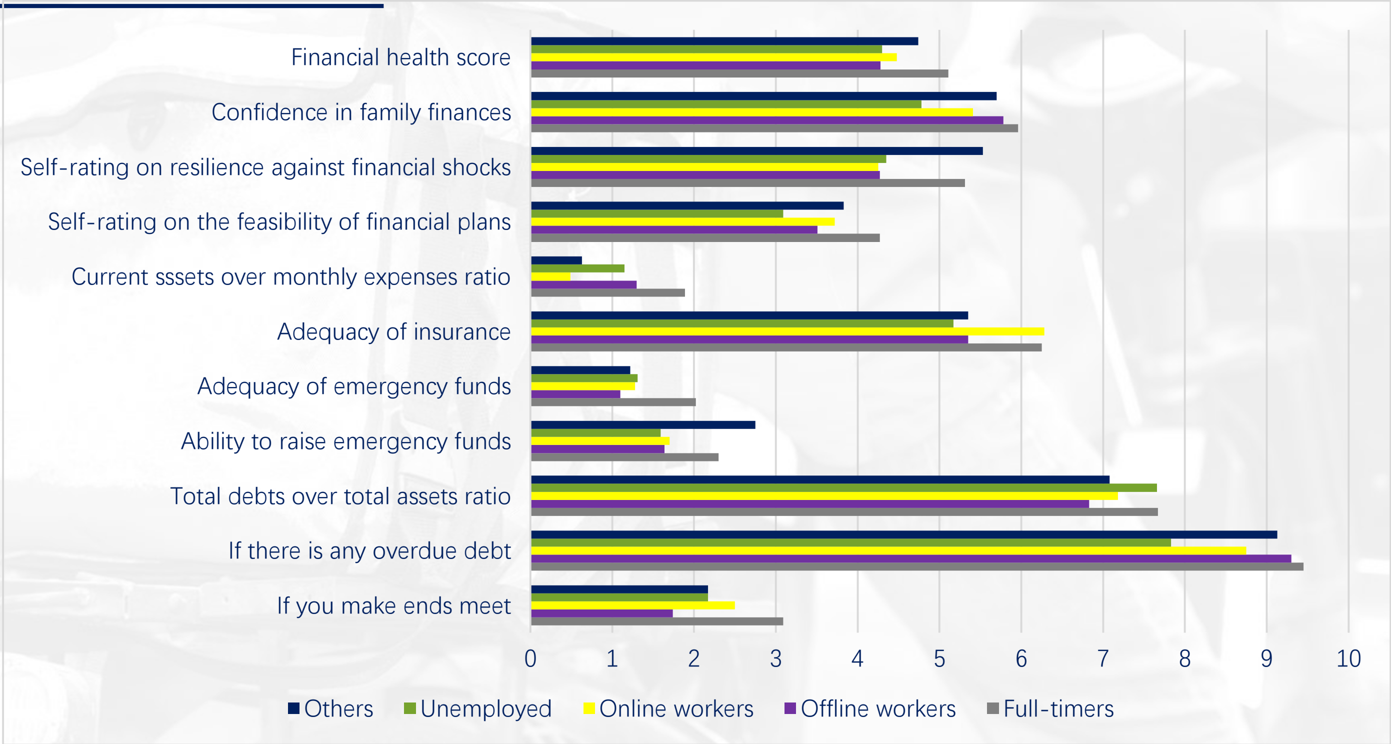
Financial Health Score After the Outbreak Struck

Financial behaviors prior to the epidemic

	Current Asset Turnover	Asset Turnover	Liability Ratio	Emergency Funds Adequacy	Ability of Raising Emergency Funds	No Overdue	Resilience against Fin. Shocks	Fin. Plans Feasibility	Confidence in Future Corporate Finances	Total Financial Health Score
No overdue			↑	↑	↑	↑	↑	↑		↑
Financial Plans						↑		↑	↑	↑
Market Expansion Plans				↑	↑		↑	↑	↑	↑
Business Expansion Plans										↑
Employee Career Planning	↑									
Emergency Funds					↑					
Med- & High-risk Fin. Invt.			↓			↓	↓	↓	↓	↓
Insurance Investment			↑	↑		↑			↑	↑

02 Diagnosis of the Wage-Earners

Average financial health scores of the working-class after the epidemic broke out



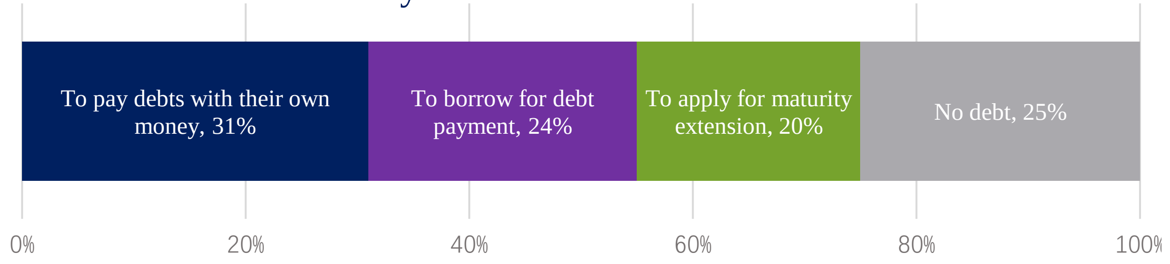
Diagnosis 1 Poor management of income & spending

The surveyed wage-earners tended to rely on their guts and estimation when making financial plans without tracking their finances, hence they were prone to fail at making ends meet or have a decreasing balance when struck by unexpected events.

Diagnosis 2 Debts were controllable

- **92%** of the working population believed their family debts would not be overdue.
- **77%** of the families had a liability ratio of less than **50%.**
- Except for those without any debt, **31%** said they could pay their debts with their own money, **24%** would need to borrow for debt payment, **20%** would need to apply for maturity extension.

Family debts would not be overdue



Diagnosis 3 Weak in emergency management

➢ Inadequate emergency funds

70% of the wage-earners were estimated to face a reduction in family income due to the impact of the epidemic

37% estimated that there would be an increase in their family expenses while another **34%** expected no change

Nearly **60%** had emergency funds for only 3 months of living equivalent to the standards prior to the outbreak. Only **20%** had enough for more than 6 months.

➢ Lack of ability in raising emergency funds

47% could raise money for 3 months of living equivalent to the standards prior to the outbreak

25% could raise money for 4-6 months

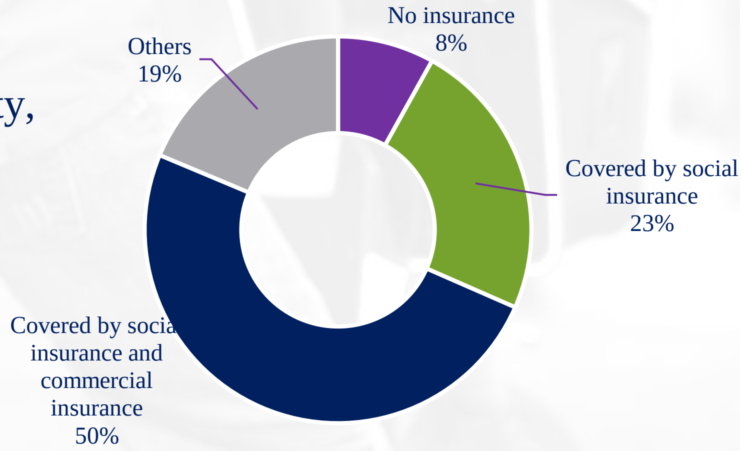
➢ It is essential to have emergency funds in place in family financial planning.

Diagnosis 4 Insurance coverage was relatively adequate

Thanks to the wide coverage of China's social insurance, risks were relatively well-managed:

- **23%** surveyed was covered by social insurance
- **50%** not only had social insurance, but also commercial insurances (health, life, accident, property, etc.)
- With growing awareness of risk management among the working population, there is a huge potential demand for commercial insurances.

Insurance coverage

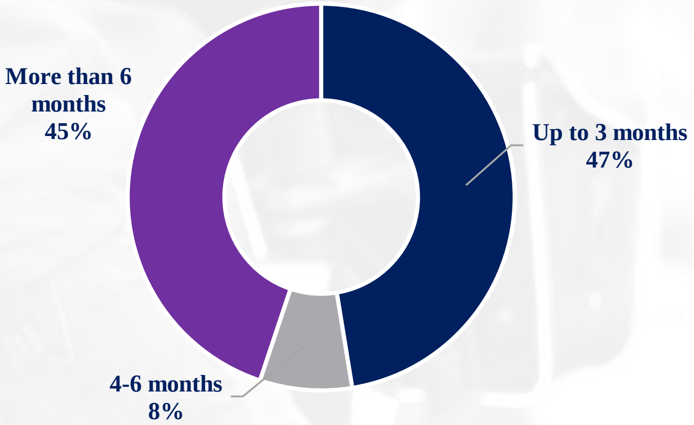


Diagnosis 5 Very poor asset management

- **47%** of the surveyed workers had current assets enough for up to 3 months of living equivalent to the standards prior to the outbreak, while **8%** for 4-6 months and **45%** for more than 6 months

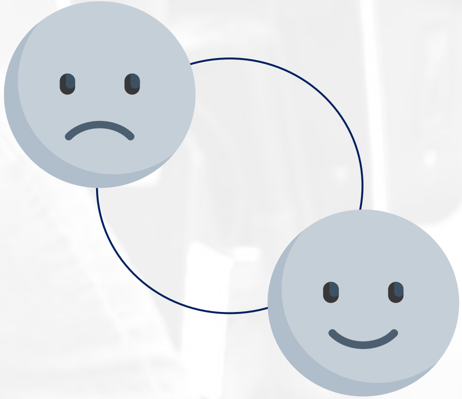
- It is necessary for the wage-earners to prioritize fixed expenses, debt payment, emergency funds, and basic insurances in their asset management practices

Current asset management



Diagnosis 6 Expectations on financial plan feasibility was slightly affected by the epidemic and varied among the 3 categories of wage-earners

- **80%** of the surveyed population had the same or lower expectation for their financial plan's feasibility
- Full-timers had the strongest resilience against risks
- Most offline workers lowered their expectations
- Some online workers raised their expectations



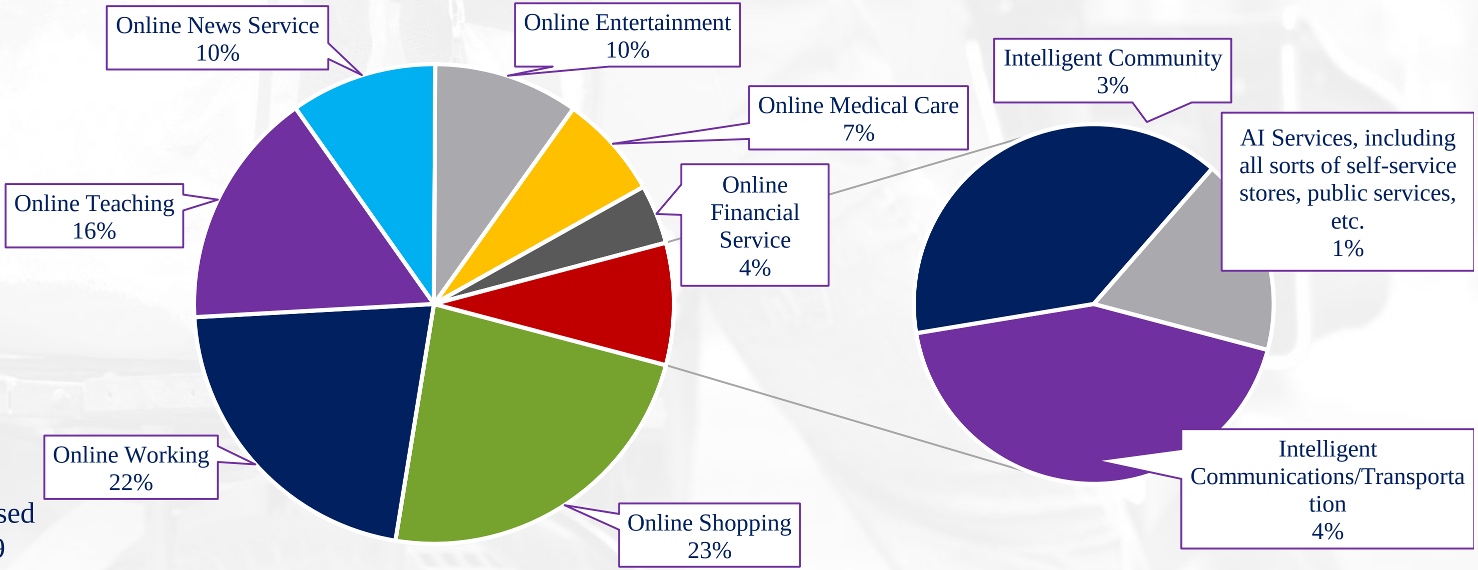
Diagnosis 7

Risk of unemployment was not very high, and the wage earners were more optimistic than we think

- **30%** of the wage-earners were positive about their future employment status .
- Another **30%** thought they might lower their living standards but would not lose their jobs.
- Only **14%** thought if they lost their current job they might be forced out of the labor market.
- **61%** scored 8 and above for “Confidence in Family Finances”, and only **30%** scored below 6.
- The optimism sends a positive signal towards the recovery of the national economy.

Diagnosis 8 Internet became the most useful tool amid the outbreak

Among all the internet tools, entertainment becomes the most popular category (online shopping: 23%). Remote office and learning also play significant roles (38%). Although the share of AI is small, there is a huge potential for AI in the future (smart community, smart transport, unmanned services, etc.)



Choices of Internet-Based Tools for COVID-19

Diagnosis 9

Good financial behaviors are the key to securing financial health

- CAFI's regression analysis of the research data shows that there is a positive correlation between good financial behaviors prior to the epidemic (make ends meet, short-term investment, no overdue debt payments, have financial plans, etc.) and the financial health score after the outbreak struck.

- It is also discovered that mid- and long-term investment will affect the arrangement of emergency funds, while medium-to-high-risk investment will put more pressure on people and lower their happiness as well as their expectations towards the future.

Correlation between good financial behaviors prior to the epidemic & the financial health score after the outbreak struck

Financial Health Score After the Outbreak Struck

Financial behaviors prior to the epidemic

	Make ends meet	No Overdue	Reasonable Fin. Ratios	Emergency Funds Adequacy	Ability of Raising Emergency Funds	Insurance Coverage	Liquidity	Fin. Plans Feasibility	Resilience against Fin. Shocks	Confidence in Family Finances	Total Financial Health Score
Make ends meet	↑										↑
Short-term Investment			↑	↑	↑		↑	↑	↑		↑
Long-term Investment	↑			↓		↑					
Med & High-risk Investment								↓	↓	↓	
No Overdue		↑	↑		↑				↑	↑	↑
Financial Plans		↑				↑	↑		↑	↑	↑

03 Policy Recommendations

Recommendations

01 The government should value the short-term effect of fiscal policies and:

- step up fiscal support towards the working class and the MSEs during and after the epidemic. E.g. reduce 6-12 months' tax; provide temporary subsidies to the unemployed;

- Incentivize the private sector to support the working class and the MSEs. E.g. encourage real estate and property management companies to reduce rent and fees during the outbreak.

Recommendations

02 Regulators and FIs should adapt their policies/products and services to the real needs of MSEs and the wage-earners

- The FIs should implement the regulators' request on extending loan maturity;
- Regulators are advised to increase the credit limit on personal digital loan, as the survey shows digital platforms are more popular among MSEs (24% need USD 15,696 – USD 142,692, 7% need more than USD 142,692);
- Regulators are advised to adjust the limit on personal digital loan's tenor, which currently is no more than a year and inconsistent with the MSEs ' needs.

Recommendations

03 Include non-bank FIs into the financial inclusion system

- Allow non-bank FIs to benefit from the preferential policies for financial inclusion businesses;

- While strictly control the financial risks of non-bank players, create a regulated space for them to grow.

Recommendations

04 Include the financial health indicators in the financial inclusion indicators system

- The current system is composed of 51 indicators in 21 categories from 3 dimensions (the use, accessibility and quality of the financial products). Financial health indicators are useful in guiding the wage-earners and the MSEs to effectively control their risks while increasing and maintaining their assets' value.

- The analysis shows that two steps need to be taken to improve the financial health of the wage-earners and the MSEs : first, ensure their ends meet and have enough liquidity and good credit history; secondly, the government and the regulators should provide them with guidance on how to make and balance short and long term investment.

Recommendations

05 Capacity Building of the MSEs and the Wage-earners

- Provide training on emergency response, disease control, career skills, financial health, etc.

- Provide the public with affordable access to a selection of practical digital tools.

05

THANKS