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# Creating Financial Infrastructure in a Large Transition Economy – Lessons from China's New Credit Bureau

***IFC and the World Bank have in recent years promoted the implementation of credit bureaus as a way of improving access to finance for both individuals and businesses. In 2003, no such structure existed for consumer credit information in China. Not only was access to financing reduced, but the quality of the entire lending industry was also affected—nonperforming loans represented a significant proportion of the portfolio, risk management practices were weak, and loans were poorly monitored. However, as this SmartLesson describes, creating financial infrastructure such as a consumer credit bureau in large countries presents a unique set of challenges.***

## *Background*

China's banking system has historically been a savings-dominated environment. One only needs to look at the ample liquidity that floods the big four banks today to be sure of that. However, with increasing prosperity and the flourishing of the small and medium enterprise (SME) market, lending (especially of the personal kind) is playing a much larger role. As is true in many developing countries, however, there are many who have been excluded from this lending boom. One of the major impediments to providing banking access for these people has been the lack of historical credit information. This SmartLesson describes the experience and lessons learned from instituting a credit bureau in China.

## *Lessons Learned*

### *1) The leader must be able to lead.*

While the need for a credit bureau was clear to us, the concept was still somewhat foreign to the banking community at large. In 2003, the main driver pushing us to act was actually a local, municipal-level government SME bureau that was willing to lead the venture, as they saw the benefits it could bring to SMEs in the area[1]. But was a non-financial government department (especially one operating at the third level of government) really the best partner to create part of a national financial services infrastructure?

Despite its eagerness and drive, the local SME bureau was problematic for several reasons. First, it was not in the business of finance, and its staff did not have enough credit experience. In addition, the bureau operated in only one municipality, did not have the influence to convince all banks to provide information, and did not have the power to demand nonpayment information. While we are all keen to root for the underdog, unfortunately in this case it would not have been able to finish the race.

In the end, due to the problems encountered, our efforts with the local SME bureau only produced a "credit investigation" (or business information services) center, which was later privatized as a local company. While other ministries in the central government also expressed their interest in working together on the credit bureau, their strong passion for SME development unfortunately did not

1 China has five levels of government. The municipal level generally comes below national and provincial, and above county.

outweigh their lack of familiarity with banking and finance.

Ultimately, in 2004, the People's Bank of China (PBOC) contacted us, seeking to engage IFC in a partnership to develop a new consumer credit bureau. Due to a strong personal connection between our Program Manager and the Director General of the PBOC, among other factors, this partnership grew strongly, and we quickly gained the trust of the PBOC as a neutral party advisor. The PBOC, which had national coverage and influence and staff who were well versed in the world of finance and credit, stood in the best position to lead the development of China's new consumer credit bureau.

*Large countries have large governments. Large governments have a large number of departments and people, all of whom have different, and sometimes competing, interests. Choosing the right government department and the right people in that department to partner with and lead the initiative was crucial in creating China's credit bureau.*

### *2) Understand the sensitivities of major stakeholders and be willing to accommodate their concerns, even if it is not "best practice."*

With the right partners on board, we set about convincing the Chinese banking community of the value of a new credit bureau. Together with the PBOC, we arranged symposiums on best practice, translated best practice codes from other countries, and held best practice workshops, which drew in all the relevant officials.

Unfortunately, there was one big problem with the conventional best practice. It said that the credit bureau industry should be private. One of China's largest banks, with 170 million personal customers, did not trust a new, unproven private enterprise with its customer data[2]. It refused to participate if the credit bureau was purely private. Without this bank's participation, the project simply could not progress. The experience begged the question—is a private structure really the best starting point in a greenfield large country environment?

To get the bank on board, the partners, with help from IFC, developed a public-private structure. While the new Credit Reference Centre (CRC) would be overseen by the central bank, it would operate as an independent "public service unit." A public service unit is an entity that charges fees to cover its costs of services. It is neither a private company per se nor a civil service institution.

In 2006, the CRC started operations under its public-private structure. By 2008, the bank that had originally refused to cooperate had made 1.5 million inquiries to the bureau, avoided over 300,000 bad loans, and saved about US$1.2 billion. Although starting as a public service unit, the CRC has a vision of becoming a joint-stock company in due course.

*Large countries have large banks. Very few of them will initially trust the data of their millions of customers with a new private firm, especially one without any prior reputation. Although a private credit bureau is best practice, a public-private structure is a good starting point to build trust and cooperation in the system. Don't be tied to best practice, as a transition to a purely private operating company can happen later.*

Stakeholders gather around the table to discuss how to set up the credit bureau.

### *3) International experts know a lot … but they need local solutions.*

In the period between 2003 and 2006, there was much discussion not only on whether the credit bureau should be public or private, but on all the minute details of the design of the bureau and its operations.

The central bank had strong ownership over the development of the credit bureau and a detailed knowledge of the financial services industry in China, but it did not have institutional knowledge on how to create or operate the new financial infrastructure. The role of IFC is clear in this kind of situation—bring in expertise from around the world to build institutional knowledge.

But how best do we use these experts, especially in a large country? Should they design a "best practice" credit bureau themselves with some input from local sources? Or should they be completely hands off and only deliver workshops and symposiums that address large audiences? The question is crucial, especially when considering the cost of consultants, the fact that they may not be familiar with the implementation realities in a large country, and the reality that it is not always clear what assistance will be needed.

We found that the most efficient way to use international experts was to engage them in a team with the central bank officials who were responsible for designing the credit bureau. During these internal sessions, which sometimes stretched on for five days, the experts would answer questions that had arisen, provide input into the proposed designs, and occasionally help structure the partner's thinking. The central bank retained ownership over the project, but they had international experts on their team

2 This was also a problem when Vietnam tried to establish its credit bureau. Commercial banks were afraid that their competitors would steal their customers. See the SmartLesson on "Developing a Private Credit Bureau in Vietnam."

that they could use to ensure that their ideas were sound.

The method worked remarkably well, and ultimately, a more China-specific system was created and the partners had themselves developed institutional knowledge through the design process.

*It is difficult in a large country for a consultant to be responsible for designing a piece of the financial services infrastructure by him/herself—the scope is simply too large, and there are too many actors and interests. Doing so runs the risk of having the recommendations gather dust on a shelf. A novel way of knowledge transfer to the local decision makers—involving international consultants as part of the design team with the local partners in an advisory capacity—not only is more efficient, but it creates a more tailored solution and saves IFC money.*

## Conclusion

Creating a financial infrastructure in large countries presents a unique set of challenges. Whether the challenges are who best to partner with among the dozens of different departments of government, how to build trust among large banks, or how to most efficiently transfer knowledge from international experts to local institutions—they all must be addressed in sustainable ways.

In large countries, these challenges mean that financial infrastructure projects will have a long and somewhat unpredictable timeframe. The IFC needs to maintain enough flexibility in its approach to adapt to the changing and often ambiguous environment. In this context, a team approach which combines local knowledge and international expertise, working consistently on the project seems to be the best approach.

Since 2006, the Credit Reference Centre has been used by more and more lenders, and nearly every lender in China is linked into the credit information system. Today, the system covers over 620 million individuals, including some 100 million active borrowers. The success of the CRC is in no small part due to the tailored approach used to address the unique set of challenges.