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INTRODUCTION

# Introduction to the special issue: Internet finance in China

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Internet finance, which is often referred to as "digital finance" and "Fintech" outside China, was coined by Ping Xie and Chuanwei Zou (2012). According to *Guidelines for Promoting the Healthy Development of Internet Finance*, which was issued by 10 ministries in July 2015, Internet finance refers to the new business model of utilizing the Internet and information communication technologies to accomplish a wide range of financial activities, such as third-party payment, online lending, direct sales of funds, crowdfunding, online insurance, and banking.[1] The operating parties in this industry include information technology (IT) companies providing financial services, such as WeChat Pay, and traditional financial institutions applying IT to their more traditional services, such as the e-ICBC service of the Industrial and Commercial Bank of China (ICBC).

Although Internet finance has been operating in China for more than 10 years, most people regard the June 2013 launch of Yu'E Bao, an online sales platform for money market funds established by Alibaba's Ant Financial Services, as the point from which the recent explosive development of Internet finance in China began. According to the Peking University Internet Finance Development Index (IFDI), since January 2014, Internet financial activities have been growing at around 100 percent a year. Taking the peer-to-peer (P2P) platforms as an example, the total number of platforms increased from 200 in 2012 to 4,029 in April 2016, and the volume of outstanding loans surged from 5.6 billion yuan to 547.8 billion yuan. Meanwhile, the number of problem P2P platforms also skyrocketed, from 16 to 1,598 during the same period. In other words, 40 percent of the P2P platforms ever established turned out to be problem platforms. It is therefore not surprising to observe that public sentiment toward Internet finance has moved from a fever pitch to fear in the past three years.

Will it be a threat to the traditional finance industry? What are the necessary conditions for the healthy development of Internet finance? There is an urgent need to study the innovation, revealing the key risks and recommending sensible policies regardless of market sentiment.

This special issue attempts to shed some light on the central question of whether China's new Internet finance economy reflects real innovation and, if so, what are the necessary conditions for its healthy development.

To start, Long Chen briefly reviews the rapid growth of Fintech in China, and then uses the case of Ant Financial to explore the reasons underlying such fast growth. He

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then argues that China's success came not from initial technology advancement, but from a much better integration between finance and real-life scenarios, a phenomenon he calls scenarization. He argues that the innovation associated with Internet finance (or Fintech) has been real, as scenarization promotes a virtuous circle among technology, finance, and real-life needs.

Ping Xie, Chuanwei Zou, and Haier Liu provide the theoretical foundations on why the innovations in Internet finance are not a bubble but real. They argue that the Internet can significantly lower transaction costs and reduce information asymmetry, enhance the efficiency of risk-based pricing and risk management, and expand sets of feasible transactions. New trends brought by Internet finance are also discussed. For example, transactions on P2P platforms may be considered as substitutes for bank deposits and loans, but also insurance products. Furthermore, interacted with the development of the sharing economy, developments in Internet finance have driven the integration of the financial and non-financial sectors. The policy implications are then discussed.

To advance systematic measurement of China's Internet finance industry, Peking University's Institute of Internet Finance developed the Peking University IFDI, with assistance from Ant Financial Services. The article by Feng Guo, Sherry Tao Kong, and Jingyi Wang discusses the construction of this index in detail. The IFDI, which was launched in December 2015, is a monthly measure that begins in January 2014 and is disaggregated across 31 provinces and 335 prefecture-level cities. It is a weighted index of six subindexes for the main business categories of Internet finance: investment (10 percent), money market funds (25 percent), insurance (15 percent), payment (30 percent), lending (15 percent), and credit rating (5 percent). Guo, Kong, and Wang show that the development of Internet finance in China has been rapid, but also with huge regional disparities. Their findings confirm that Internet finance should not be considered as a bubble, since its development is closely associated with the development of the local traditional financial sector, infrastructure, and local economic development.

The fourth article in this special issue assesses the potential risks associated with Internet finance in China, and discusses the implications for the regulatory framework, through a case study of P2P lending platforms. Jingyi Wang, Yan Shen, and Yiping Huang use publicly available platform-level data up to December 2015 to identify the risk factors associated with different platforms. Their article aims to identify the characteristics of problem platforms and evaluate whether the draft regulatory framework is appropriate. Their findings imply that treating P2P platforms as a pure information intermediary instead of a credit intermediary may not be effective. The article suggests that the regulatory authority should be prudent toward assigning regulatory responsibilities to local financial bureaus, and a requirement of minimum registered capital is necessary. The article also makes some recommendations on information disclosure and risk management requirements for the P2P lending industry.

If one agrees that the majority of the P2P platforms are credit intermediaries rather than information intermediaries, healthy development of P2P platforms will not be practical if a well-functioning credit reporting system does not exist, since such systems can effectively help to alleviate information asymmetry and reduce transaction costs.

Zhuo Huang, Yang Lei, and Shihan Shen study the status quo of the personal credit reporting system in China. Their article reviews historical developments, describes the current structure of China's government-oriented personal credit reporting system, and analyzes the challenges and opportunities for the next generation of China's personal credit reporting system. The authors find that it would be difficult for the current centralized credit reporting system to meet the demands of the development of Internet finance. The article suggests taking advantage of the technological advancements achieved in Internet finance and big data to develop a well-functioning personal credit reporting system.

As an industry in the new economy sector, the contribution of Internet finance to the growth of gross domestic product (GDP) is probably underestimated, since the official statistics focus more on the traditional sector. The last article, by Yan Shen, Minggao Shen, and Qin Chen, introduces the New Economy Index (NEI), which provides the background for the development of Internet finance in China. With more than three decades of fast economic development, China has entered a "new normal" stage with a slower economic growth rate. There have been concerns about whether China can avoid the middle-income trap and achieve sustainable development. The NEI aims to provide a measurement of the proportion of the new economy in GDP. Policy implications are then provided, where healthy development of Internet finance needs to be pursued with strengthening of the new economy sector.

Despite the rapid development of Internet finance over the past several years, debate about its future probably will continue in the perceivable future. Optimists, like Ping Xie, argue that Internet finance represents the third type of financial intermediation, after direct and indirect financing, and that it could completely revamp the traditional financial industry. Others are more skeptical, pointing out that Internet finance is mainly a Chinese phenomenon and is actually a product of regulatory arbitrage, which could therefore evaporate once financial regulations tighten to levels equivalent to those in advanced economies.

The six articles in this special issue make a preliminary attempt to address the central question of whether Internet finance is a real innovation or simply a bubble. Internet finance has the potential to add real value to financial transactions, especially via enabling commercially profitable transactions to meet the demand for credit that previously was commercially unviable. Whether this potential can turn into real business, however, will depend on several conditions, where some have been discussed in this special issue and others deserve further study.

This special issue was organized by the Institute of Internet Finance at the Peking University, which was established to conduct research on dynamic Internet financial activities. The Institute provided financial assistance in commissioning the articles for the special issue. It also helped organize a workshop to review the articles. Several of the articles are based on research projects funded by the Institute.

## Note

1. The *Guidelines* uses a narrower definition of Internet finance, where digital money is not included. Huang et al. (2016) provide a broader scope of Internet finance.

## Disclosure statement

No potential conflict of interest was reported by the authors.

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