Universität Zürich[UZH]

Microfinance Wholesale Funds: The Case of China

Christian Buchmann

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Executive Summary

As part of the government's poverty alleviation campaign for *building a new socialist countryside*, the Chinese government has launched a range of initiatives to strengthen its rural financial system during recent years. New legal forms of financial institutions have been introduced, laying the foundation for commercial microfinance in the country. Although significant progress has been made, the Chinese microfinance sector is still at an early growth stage and additional initiatives are needed to enhance the capacity of microfinance institutions. This thesis evaluates whether the establishment of a Chinese microfinance wholesale fund can successfully contribute to the further development of the sector.

In the past, microfinance wholesale funds have been implemented in different countries to foster the development of microfinance markets by providing funds and technical assistance to microfinance institutions. Building on published literature about the wholesale funds' performance records and on the theory of financial intermediation, this paper assesses the efficiency of wholesale funding frameworks. While there is theoretical justification for the implementation of centralized wholesale funding structures, practical experiences show mixed results. Particular issues include the limited availability of eligible investment objects, political disbursement pressures and disincentives for microfinance providers to access commercial markets for refinancing. Hence, the efficiency of wholesale funding frameworks is highly contextual. The analysis discloses market criteria that support the establishment of a wholesale fund and success factors for the fund's design and execution.

Ten semi-structured interviews with experts in the Chinese microfinance sector provide the basis for the transformation of the general findings to the case of China. Concluding from a qualitative analysis of the data, a dual structure for the future funding framework of the Chinese microfinance sector is proposed. First, the establishment of a Chinese microfinance wholesale fund is recommended as a transitory mechanism. The fund serves to fill current funding gaps and emphasizes capacity building among the retail microfinance institutions. It favorably offers debt investments to Microcredit Companies and NGOs. Second, alternative funding channels between domestic commercial banks and microfinance institutions need to be enhanced in order to enable the sector's commercialization in the long run. This involves the improvement of the market's transparency and the promotion of commercial banks' capabilities to lend to microfinance institutions.

The main contribution of foreign institutions to the development of the Chinese microfinance sector is the transfer of international expertise, methodologies, and technological solutions to China. Providing consulting services and technical assistance for the different players is essential, as corresponding competencies are still scarce within China. The high liquidity of China's financial sector, significant transaction costs on foreign investments and the current political situation imply that foreign investors should not extensively allocate additional capital to China. Accordingly, the proposed microfinance wholesale fund preferably raises capital primarily from domestic sources. The Chinese government can improve the prospects of the proposed funding framework by adjusting the regulatory framework of the microfinance sector. In particular, the regulation of NGOs' microfinance business and the liberalization of Microcredit Companies' regulatory requirements are likely to increase the efficiency of wholesale funding in China.