SUPPLY OF FINANCIAL SERVICES IN CHINA: A STUDY OF DOMESTIC MONEY TRANSFERS

Jennifer Isern[1]
Nova Southeastern University, USA.
E-mail: ijennife@nova.edu

Enjiang Cheng[2]
Victoria University, Australia.
E-mail: enjiang.cheng@vu.edu.au

Xu Zhong[3]
People's Bank of China, China.
E-mail: xuzhong@pbc.gov.cn

ABSTRACT

This study addresses the supply of financial services, especially money transfers, in the People's Republic of China. With an estimated 95 million domestic labor migrants, the potential market for remittances is estimated between USD 23 billion and 40 billion in 2005 and growing. Labor migration in China has been characterized by a large outflow of agricultural laborers from rural inland areas moving to coastal provinces to work in manufacturing and service sectors, mostly on a temporary basis. Migrant workers tend to remit funds to their families, and a growing number also receive wages on prepaid or debit cards. The money transfers market is dominated by China Post, and other financial service providers currently have modest market share. Branch placement and retail strategy of financial service providers plus their responses to structural constraints such as the

1 Jennifer Isern, MPA, CFA, Nova Southeastern University, 1746 Willard Street NW #3, Washington DC 20009, Tel 1.202.588.5472.
2 Dr. Enjiang Cheng, Researcher, Victoria University, Australia.
3 Dr. Xu Zhong, *People's Bank of China, China.*

payments system are the current drivers of competitive advantage in China's money transfers market. This is a growing market segment that could be promising for financial institutions, as domestic remittances were estimated between USD 23 billion to 40 billion in 2005. Beyond the money transfers market, migrant workers and their families may also seek other financial services such as deposits, consumer loans, and home-improvement loans.

Key words: China, financial institutions, consumer demand, financial services, money transfers, remittances, migration.

JEL Codes: G14, G21
Exchange rate: 1 US$ = 7.812 RMB (rate quoted on 7 January 2007).

I. INTRODUCTION

This study addresses the supply of financial services in the People's Republic of China with a focus on money transfers for a specific client group of millions of migrant workers and their households. Related data on the demand for money transfer services is treated in a separate article (Isern, Cheng & Xu, 2007).

Money transfers such as remittances represent a promising market for financial services (Isern, Deshpande & van Doorn, 2005). The authors estimated the potential market for Chinese domestic remittances to be between USD 24 billion to USD 42 billion in 2005.

Section one of this article reviews the literature on labor migration and remittances, financial sector development and market structure, and supply of money transfers in the People's Republic of China. Section two provides the research objectives. Section three describes the research methodology including the pilot and main studies, survey instrument, data analysis, and the population and sample. Section four summarizes the research findings. Section five cites the study limitations and areas for further research. Section six concludes and provides implications for financial service providers and policy makers.

II. LITERATURE REVIEW

A. Labor Migration and Remittances in China

China's domestic labor market differs from those of many other developing countries. Prior to the economic reforms in the late 1970s and early 1980s, the free migration of labor from rural to urban areas in China was severely restricted. Following economic reforms, restrictions on the movement of people from rural to urban areas have been removed gradually. Under a dual economic model (Lewis, 1954), the increasing number of domestic migrant workers in China has been shaped by increased agricultural productivity and subsequent surplus rural labor, increases in foreign and domestic investment resulting in greater demand for labor in coastal regions, an incomplete market for farmland, and China's restrictive residential registration system (*hukou*). Based on author estimations, there are approximately 95 million migrant workers in China as of 2005.[4] By any yardstick, this internal migratory flow represents "the largest peacetime movement of people in history" (Murphy, 2002, p.1).

These special characteristics of China's labor market suggest two key implications for this study. First, people are allocated land and residences in their home villages, prompting them to leave family members at home. These factors increase the likelihood that migrants will return home. This pattern of domestic and temporary migration has helped generate a significant inflow of money from migrant workers to their families back home. The major factors that determine the proportion of remittance to total income include the migrant worker's income, whether family members are living with him (or her), and family requests for money (Isern et al., 2005).

4 Others estimate 60-120 million internal migrants in China (IOM, 2005; Kynge, 2004).

B. Financial sector development in China

China's financial services market is largely a bank-based system, as capital markets are still developing. Sustaining China's remarkable economic growth depends on the health of the financial sector, although there are many factors at play. China's ascension to the World Trade Organization brings greater competition in all sectors, including the financial sector starting in 2007. National banks continue to address high levels of non-performing loans, ongoing restructuring, and shifts in business strategy from corporate to broader banking services (von Emloh & Wang, 2004).

Few studies have specifically analyzed the money transfers industry in China. Li (2001) studied migrant workers in Beijing and found that over forty percent of respondents sent money home, with an average of USD 311 per transfer. An IFAD study on remittance in China was conducted by the Financial Stabilization Bureau of the People's Bank of China (2004) to provide summary data on both international and domestic remittances.5 An earlier study by Zhu (2003) analyzed remittances services offered by China Post through the Bureau of Postal Savings and Remittances.

Several factors influence the market structure for money transfers in China: regulations, physical presence, and retail strategy. The major money transfer service providers include China Post and the four largest state-owned banks: the Agricultural Bank of China (ABC), Industry and Commerce Bank of China (ICBC), People's Construction Bank of China (PCBC) and the Bank of China (BOC).6 According to prevailing regulation, only commercial banks (including city commercial banks), urban and rural credit cooperatives, and China Post are authorized to conduct money transfer and settlement transactions in China. To date, international firms such as Western

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5 IFAD is the International Fund for Agricultural Development.

6 The market for money transfers, including domestic remittances, in China is largely dominated by formal financial institutions. There have been few reports of informal service providers for domestic remittances. Given low fees for domestic money transfers compared to charges for similar services in other countries, informal service providers may not see an incentive to enter the market.

Union and MoneyGram can conduct only international money transfer operations by collaborating with one of the licensed operators in China, such as a commercial bank, China Post, or credit cooperatives.

III. DATA AND METHODOLOGY

The data and information for this article are taken from a 2004-2005 survey of financial institutions and migrant workers. The broader study also analysed the demand of financial services, especially money transfers, for this client group, and those findings are reported in a separate article. A multi-phase research approach was used in this study. First, a pilot study was conducted to adapt and finalize the questionnaires to the Chinese context. Second, surveys were conducted of migrant workers, households sending migrant workers, and financial institutions that serve these clients.

The Chinese census defines migrant workers as rural laborers transferred out of their home county for more than six months. Most inter-provincial migrant workers originate from the Central and Western provinces and are employed in the coastal provinces (Development Research Centre of the State Council, 2005). These findings were confirmed by the authors' field surveys in Hangzhou, Zhejiang Province, where approximately 90 percent of the migrant workers sampled were from the less developed Central and Western provinces.

Zhejiang was selected as a sample destination province for migrant workers. Given rapid development of private enterprises and foreign investment in the province, Zhejiang is one of the primary destinations for migrant workers in China. Hunan and Sichuan provinces were selected as representative of socio-economic conditions and patterns of labor migration in Central and Western China, respectively. Of the 400 migrant workers sending remittances surveyed for this study, 87 percent were Han Chinese. The remaining 13 percent of people identified as Miao, Tujia, Mongol, and other ethnic groups. Migrant workers in the study represent a younger and more highly educated work force from rural China, especially from lower-income areas of China. Over half of the migrant workers were middle school graduates or above. The data show that women migrant workers, representing 28 percent of the sample, have slightly lower levels of education. Most people surveyed are married (70 percent), and a majority chose to leave their children at home while they migrated for work (60 percent).

The data on migrant workers from Hangzhou of Zhejiang Province and rural households from Hunan and Sichuan provinces were coded by region and by household characteristics, including, remittances received or sent and comments on quality and scope of available remittance services. Three households in Hangzhou with incomplete information (of 400 total households) from the sample in Zhejiang Province were deleted from data analysis. The household data were analyzed using Excel and Stata, and a range of descriptive statistical techniques were applied. Means, standard deviations and correlation coefficients were calculated for all variables for both remittance-sending clients (migrant workers) and receiving clients (rural households). Information from migrant workers was then compared with information from receiving households (e.g., the quantity and mechanism for the funds sent and received). This comparison and verification of data consistency and reliability helped the study team reach conclusions about available remittance services. Finally, any inconsistency regarding information on fees charged and products available was checked again through interviews with the provincial offices and head-quarters of the service providers and by verifying written materials available from the service providers, their websites, and government sources.

IV. RESEARCH FINDINGS

A. Market Structure

Physical presence and access to the national payment system affect the market structure. China Post’s extensive branch network of 57,136 points of service, of which almost 42,000 in rural areas, gives it considerable advantage in the money transfers market. Of these points of service, approximately 24,000 are connected electronically to headquarters, thereby facilitating more rapid money transfers. In

2004, China Post made an estimated 180 million remittance transactions for a total volume of 213 billion RMB (USD 27.3 billion), of which 70 percent went to rural areas. Migrant workers are believed to be the main client group sending remittances through China Post, and they may account for over 90 percent of total transfer volume to rural areas (Zhu, 2003).

In contrast, the big four banks have retreated from rural areas over the past ten years. The option of remitting through commercial banks is basically available only to migrant workers and their families who are already clients of commercial banks or who live near branch offices.

While rural credit cooperatives (RCCs) are located in China's rural townships and *xiang*, they do not have a nationwide money transfer and payment system. As a result, money transfers sent through RCCs are slow for clients and difficult for individual RCCs to transmit. In many cases, RCCs have discouraged their clients to remit money. To overcome their lack of direct access to the payments network, some RCCs have applied to the People's Bank of China (Central Bank) to route transfers through its real-time large settlement system or established alliances with commercial banks. However, RCCs report that these approaches are not profitable given fees, mandatory reserves, and competition with those same commercial banks. In response to this lack of access to payment systems, RCCs in more than ten provinces have established protocols for transferring funds within their province but this does not extend to national service. Reforms now underway will create federations of RCCs that may eventually provide network services such as linking to the payment system.

As seen in Table 1 below, China Post offers three major products for money transfers in China: post money orders, electronic express money transfers and green card (debit card) services. Compared to remitting through the commercial banks, postal money orders are slower and in some cases, branches at the receiving end charge an additional fee for delivering cash to the recipients, with or without notification or approval of recipients. In Renshou and Shimei counties of Sichuan, the post offices acknowledged that some post offices in their counties charged 5 percent to deliver cash. The express service offered by China Post is more expensive than similar services provided by commercial banks. The Post Office charges an additional ¥1-10 (USD 0.13 to 1.28) for its express services which are only available in offices connected to their national electronic network. Nevertheless, one does not need a postal savings account to send and receive remittances, and this is a major advantage over services offered by commercial banks. Compared to China Post, commercial banks in China usually charge a low fee for their remittance services (Table 2 below). The fee structure on money transfers offered by commercial banks has been subject to the regulations set by the People's Bank of China (PBOC) and the National Development and Reform Commission (NDPC).

Table 1
Comparison of Remittance Products by Service Providers in China

Institution	Bank Account Required[1]	Bank Card Required[2]	Time for Transfer	Inform Recipient on Arrival	Service Availability[3]
1. Post Office					
Regular Services (Post Money Orders)	No	No	3 to 5 days	Yes	Township & *Xiang*
Express Service (Electronic)	No	No	24 hours	Yes	Township & *Xiang*
Green Cards (Electronic)	Yes	Yes	Real time		Mainly townships
2. Commercial Banks					
Electronic transfers	No	No	24 hours		Large townships
ABC National Roaming	No	No	Real time		Large townships
ABC Express Service	No	No	2 to 4 hours		Large townships
ABC Card Service	Yes	Yes	Real time		Large townships
PCBC Fast Service	Yes	No	Real time		County seat
ICBC Express Service	Yes	No	Real time	No	County seat
3. RCCs [4]	Yes	No	> 7 days	No	Township & *Xiang*

Sources: Various websites for Post Office, ABC, PCBC, ICBC, and the PBC.
Notes: 1.Whether a money transfer recipient needs a bank account (usually a savings account). 2. Whether a recipient needs a bankcard (usually a debit card). 3. Whether the service provider is present at the county seat, large townships only, or in most townships and *xiang*. 4. In general, to remit through an RCC requires more than one week, as the RCC must remit the funds via a commercial bank.

Money transfers offered by banks can be divided into three broad categories: a) standard money transfers to a bank customer (24 hours); b) real-time money transfers to bank or non-bank customers at a higher fee; and c) discounted real-time money transfers to a bank cardholder. ABC National Roaming, ICBC Direct Vehicle and PCBC Fast Remittance Service are real-time services with higher fees. Fees noted in Table 2 do not include additional, sometimes undocumented, fees charged by service providers or costs of compulsory savings. Rural credit cooperatives are not represented in Table 2 given their lack of standardized fees across the more than 30,000 individual RCCs.

Table 2
Comparison of Charges for Remittance Services in China (USD)

	Fees in US$[1]	Fees for a Remittance of		
Institution and Service		$64	$256	$1280.1
1. Post Office				
Post Money Order	1%;	$0.60	$2.60	$6.40
Electronic Transfer	1%+ 0.13-1.28, min 0.26, Max 6.4	1.30	3.20	6.40
Green Card Service[2]	1%; Min 0.26, Max 6.4	0.60	2.60	6.40
2. Commercial Banks [3]				
2.1. Bank electronic transfer				
To a bank customer	Standard fee	0.70	0.70	1.30
To a non bank customer	1%; Min 0.26, Max 6.4	0.60	2.60	6.40
2.2. ABC Express Service				
To a bank customer	30% overcharge	0.90	0.90	1.70
To a non bank customer	1%, Max 6.4	0.60	2.60	6.40
2.3. ABC National Roaming				
To a bank customer	Standard fee	0.70	0.70	1.30
To a non bank customer	1%; Max 6.4	0.60	2.60	6.40
2.4. ABC Card Service	0.5%; Max 6.4	0.30	1.30	6.40
2.5. PCBC Fast Service				
To non card holders	1%; Max 6.4, Min 0.26	0.60	2.60	6.40
To a cardholder	0.5%; Max 6.4	0.30	1.30	6.40
2.6. ICBC Express Service				
To non card holders	1%, Max 6.4, Min 0.26	0.60	2.60	6.40
To a cardholder	0.5% Max 6.4	0.30	1.30	6.40

Sources: Websites of the China Post, ABC, PCBC, ICBC, and the PBC.
Notes: 1. 1% and 0.5% refer to the percentage of the value of remittance; Max – maximum fees, min – minimum fees. 2. Green card is a debit card issued by China Post. 3. Refers to the big four banks.

As seen in the tables above, using a bank card can cut remittance fees in half for a remittance up to ¥5,000 (U$640). ABC national roaming is the second best option, as recipients are not required to have an account and the transfer is processed in real time. Compared with the similar products, remittance products offered by China Post are generally more expensive. The extensive branch network, access to the payments network, and lack of a need for a bank account at China Post contribute to its large market share. Lack of bank points of service and poor quality service from RCCs add to China Post's advantage.

Based on the sample counties of Hunan and Sichuan, Central Bank estimates of remittance volume per financial service provider are provided in Table 3. China Post dominates the market in Sichuan, while in Hunan, the big four state-owned commercial banks have a larger presence. The findings for Sichuan are affected by bank closing branches in more remote Western provinces of China.

Table 3
Remittance Inflows from Migrant Workers for the Service Providers in Hunan and Sichuan Provinces (%), Estimated, 2004[1]

	Sichuan Province			**Hunan Province**		
	Renshou	**Shimian**	**Anyue**	**Lixian**	**Wangcheng**	**Xiangtang**
Total Remittances (U$ '000) [2]	8,817	90	15,881	2,796	3,174	7,405
Market share per institution (%)						
State-owned commercial banks						
ABC	41	3	15	23	3	17
PCBC	1	n.a.	1	18	1	1
ICBC	1	33	4	37	-	-
BOC	n.a.	n.a.	6	4	93	2
Sub-total state-owned commercial banks	43	36	26	82	97	21
RCCs	12	41	22	10	-	57
China Post	45	23	52	8	3	22

Sources: PBOC county offices in Renshou, Shimian, Anyue of Sichuan, Lixian, Wangcheng and Xiangtang of Hunan Province.

Notes: 1.The figures in the table are estimates provided during interviews with service providers. N.a.: Not applicable. For example, in Renshou there is no BOC office, and in Shimian there is no BOC or PCBC office. 2. Total value of the incoming remittances for that county.

B. Customer Service

Based on interviews and observations with financial service providers in the study zone, service fees were not clearly posted, and clients noted confusion about fees. In some cases, fees for basic (slow) service are posted, and additional charges for faster service are only available on request, especially for branches of China Post. Personnel frequently offer clients the most expensive service without mentioning any less expensive alternatives. One reason for this may be that diverse service options and rates are complex for staff to explain and for clients to compare. Since express services are priced using a simple one percent fee of the transfer amount, both staff and clients may prefer them. Some service providers require compulsory savings of a portion of the transfer and charge additional fees with no justification. For example, fees for express money transfers at some branches were as much as thirty percent higher than rates authorized by the Central Bank and other authorities.

C. Client Preferences

Migrant workers in the sample remit a relatively small amount of money home for each remittance. An average migrant worker remits on average between USD 60 and USD 120 approximately 3-6 times each year. Remittance behavior differs for construction workers in the sample who are usually paid a large sum of money at the end of a construction project. Migrant workers reported that they prefer to send smaller amounts more frequently to avoid loss of funds and to control how funds are used by the recipients. Most people surveyed are married (70 percent) and have left children at home (60 percent).

The study found that 45 percent of respondents channeled their remittances through the Post Office, while 13 percent used other financial institutions such as rural credit cooperatives or banks. Card-based money transfers such as debit and credit cards were used by more than fourteen percent of respondents. Twenty-six percent of respondents opted to carry money home during their infrequent visits, such as for the two major national holidays. The proportion of migrant workers who hand carry funds suggests that formal remittance providers are not efficient and/or that the money transfer market is under-developed. Hand carrying money is insecure and includes high costs for travel and opportunity cost of time away from work. Migrant workers are frequent victims of robbery and violence, especially around holiday periods when they return home on trains and buses. Based on the authors' knowledge and information to date, informal remittance services seem quite limited in China. This stands in stark contrast to the large informal market for domestic and international remittances in many other countries (Isern et al., 2005).

Migrant workers ranked two criteria as first priority in selecting a money transfer service: i) location of service providers in relation to their family and ii) total cost of the service including all fees and transaction costs. Respondents cited delivery speed, service quality, and transaction security as secondary factors. Migrants were unsure of procedures to send money through formal channels, and they felt that fees to remit were too high.

Demand for financial services seems to be related to education level and income. Respondents with higher education levels reported using electronic banking services such as debit and credit cards. No respondents used other forms of e-banking already available in some areas of China such as those made by internet or cell phones. A limited number of respondents had received debit cards from their employers, in cooperation with a bank, to facilitate salary payments. Compared with those who use formal remittance services, the migrant workers who hand carry money home had lower incomes and hence send less money home. People who preferred to hand carry funds home also tended to be older with lower levels of education.

The respondents reported sending a relatively high proportion of their income home to family members. The average migrant worker in Zhejiang remits 35-40 percent of his/her total income. The actual amount of funds remitted depended on several factors. For example, a single migrant worker sends on average 20 percent of his income home. Results are similar for workers living with a partner and children while working outside of the home area. When children remain at home, migrant workers in the survey remitted 20-35 percent of total income. When both the partner and children remain at home, the migrant worker would remit 60-70 percent of total income.

Remittances have a distinctly seasonal flavor in many countries, and study findings suggest similar patterns in China. Respondents tended to send money home or hand carry funds when they return home for major festivals such as the Spring Festival (usually in February), mid-Autumn Festival (September or October). Important family events (periods to pay school fees, parent birthdays, and building an addition on a house) also stimulated migrants to remit funds. Migrants with a partner and children remaining behind made more frequent payments (e.g., every two to three months). Income from migrant workers influenced demand for other financial services such as deposit services.

These findings suggest that migration and remittances are changing consumption and investment decisions by rural households in China, and this will have profound implications for rural and urban markets and the financial services industry.

V. LIMITATIONS AND AREAS FOR FURTHER RESEARCH

The measurement of variables with informants is subject to the ubiquitous problems of key informant bias and concern over use of personal financial data, employment information, and migration status, all of which are sensitive in the Chinese context. To mitigate this risk, the questionnaires were based on similar questionnaires used in successful market studies conducted in India and South Africa. The questionnaires were adapted to the Chinese socio-economic context and pilot tested before being finalized and translated.

This study is limited to two provinces in China, and further research is required to expand the dataset and theoretical basis. Given the current lack of empirical studies on remittances to and within China, additional research is warranted on client access to money transfers, household use of remittances, and market development for remittances and other financial services.

VI. CONCLUSION AND IMPLICATIONS

The financial services market in China is changing rapidly. The market for money transfers by labor migrants within China is significant and growing. Consumer segments are developing in sometimes surprising ways, and this study focuses on the specific segment of approximately 95 million labor migrants.

Market structure dramatically affects the money transfers market. Structural factors constrain financial service providers from entering the market, and as these are addressed, the market will become more competitive. In addition, specific socio-economic characteristics of migrant workers must be considered when designing financial services for this promising market. Amounts remitted and channels for sending funds varied according to education, income levels, number of direct family members co-migrating, and other factors.

Clients value transparent information on fees, speed of service, and efficient recourse in the event of delay in transferring funds. To be successful with this consumer segment, financial service providers must consider specific customer preferences and incorporate them into product design, service quality standards for staff, and marketing. Financial service providers with broad branch coverage and ATM coverage should consider deploying this infrastructure for money transfers. In addition, licensed financial institutions should study the feasibility of linked financial services such as deposits, consumer loans, insurance, etc. Mobile banking through cell phones and retail points of service are already being introduced in China and have good potential for success based on lessons from the Philippines, South Africa, and elsewhere.

For policy makers, competition from other service providers may help improve quality of services, especially in the Western provinces and in rural areas. Competition can be enhanced by improving the payment and settlement system and allowing business alliances that could expand the supply of services.

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