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Research on the Risk Characteristics and Countermeasures of Inclusive Finance

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Abstract: Inclusive finance is of great significance to supporting economic growth, realizing social equity and enhancing financial inclusiveness. The risk management of inclusive finance is the key to the sustainable development of economy and finance. The purpose of this study is to analyze the sources and characteristics of risks in the development of inclusive finance and explore effective ways to mitigate potential risks. First, this study reviews the origin of inclusive finance and analyzes two representative successful cases in the international scope. Then, the risk sources and characteristics of inclusive finance are summarized, and the difficulties and obstacles of inclusive finance management are found from the perspective of risk. Finally, the research discusses the path of inclusive financial risk management, and puts forward a series of management directions and policy suggestions from the two dimensions of financial institutions' operation and government support.

1. Introduction

In the process of deepening the development of the financial system, influenced by the exclusion of traditional finance and the lack of financial innovation, financial services show a trend of polarization among coutries with different levels of economic development. Especially in the developing countries, financial resources are excessively concentrated on the upper level, and their availability and coverage ratio need to be improved. From the perspective of various countries, the distribution of financial resources also needs to be balanced. The financial needs of rural areas, micro, small and medium-sized enterprises (MSMEs) and urban low-income people, which are difficult to reach by the traditional financial system, have not been fully met, and it is difficult for them to share the benefits of financial development.

In order to solve the above problems, in 2005, the United Nations formally proposed the concept of inclusive finance and defined it as "a financial system that can effectively and comprehensively serve all classes and groups of society, especially the poor and low-income population". Since then, financial inclusion has become an important financial practice in the world and made significant progress. It becomes an important force in promoting social equity and economic growth.

However, with the rapid development of inclusive finance, risk management and control have become a problem that cannot be ignored. Therefore, this study aims to analyze the types and characteristics of risks in the development of inclusive finance and put forward corresponding management paths, which provide necessary guidelines and strategies for alleviating potential risks.

2. Case Analysis

Due to the different levels of economic and financial development in different countries, the ways of inclusive financial practice are significantly different. This research selects a representative case in China and another case in the international sphere respectively.

Internationally, Brazil promulgated the bank agency regulations in 1999, which provides a legal guarantee for inclusive finance services and expands the channels and coverage of inclusive financial services. The rapid development of agency banks has become the biggest feature of inclusive finance in Brazil. Under this mode, banks cooperate with non-bank institutions in the financial field. Retail stores, lottery outlets, pharmacies and post offices can all act as correspondent banks. People do not need to have bank accounts to enjoy financial services, thus greatly increasing the number of population enjoying inclusive finance services. In addition, Brazil has introduced simplified accounts and microfinance programs, reduced the conditions for individuals to open accounts, and set up simplified credit services for low-income people, farmers and other groups.

A typical example of China's inclusive finance practice is the Ant Financial services of Alibaba Group. In October 2014, Alibaba announced the foundation of Ant Financial Services Group, with a business scope covering payment, insurance, financial management and loans, etc., forming the whole industrial chain layout of inclusive finance. The biggest feature of its operation is relying on the Internet financial platform, using big data, cloud computing and other emerging technologies to make users have equal access to financial services, and the scope of inclusive finance is continuously expanded. In 2023, Alipay had 1.3 billion real-name users worldwide. In 2016, Xizang, Qinghai and Gansu, three remote inland provinces, ranked the top three in terms of mobile payment penetration, reflecting the crucial role of mobile payment channels in improving inclusive finance services in less-developed areas.In the field of small and micro-sized firm financing, Ant Financial has provided tens of millions small and micro-sized firms with comprehensive financial services including online and offline, further consolidating its leading position in the financial field.

3. Sources of Inclusive Finance Risks Under the New Situation

The attribute of inclusive finance objectively determines that relevant financial business has higher risk and cost and relatively low rate of return. There are two main sources of inclusive finance risk, one part is the target audience risk,which is from the high risk characteristics of the service object itself, and the other part is the technical risk brought by the use of Internet technology[1].

The service object of inclusive finance is usually micro, small and medium-sized enterprises (MSMEs) and the disadvantaged groups.The latter mainly include urban low-income people, laid-off workers and vulnerable groups etc. With low income level, poor assets and poor repayment ability, they are considered as a high-risk group. With the development of China's economy, micro, small and medium-sized enterprises (MSMEs) have developed rapidly, but they have weak foundation and poor anti-risk ability, which increased the credit risk coefficient of banks.It is difficult to achieve effective risk management of them. According to the statistics, in terms of the non-performing loan ratio, the average value of small and micro-sized firms has always been higher than that of commercial banks.

As an emerging form of financial innovation, Internet finance is playing an active role in inclusive finance. It has broken the geographical restrictions of traditional finance, helped financial innovation, made financial services more popular and inclusive and promoted economic development. However, there are also technical risks in inclusive finance under the Internet environment, mainly including possible risks in the technical architecture of digital inclusive finance platform, data security and privacy protection.

In such a background of a new era, with the development of the Internet technology and the new media, the liquidity of various risks is accelerated, the correlation is enhanced and the infection is crossed. Additionally, audience risks and technical risks are easy to produce overlapping and diffusion effects with the accelerated evolution of risks through information means, which makes risk transmission faster and more extensive. It brings difficulties and challenges to the risk management of inclusive finance.

4. Types of Inclusive Finance Risks

Inclusive finance is an important branch of finance. In the course of its development, it has derived its own risk characteristics on the basis of financial risk types, mainly including the following several parts.

Credit risk refers to the risk that the counterparty, namely the debtor defaults, which is widespread and causes great harm. Especially for inclusive finance, the service target is mainly long-tail customers, who are generally lack of business information and credit information, and it is difficult for them to repay loans. It is more difficult for financial institutions to control such risks. In fact, credit risk is the primary risk faced by China at the present stage. Due to the particularity of the service objects, many inclusive finance customers lack the traditional credit records, making it difficult to carry out accurate credit evaluation.

The fluctuation of the price of financial products in the financial market is affected by the exchange rate, interest rate and other factors, which will make the actual returns deviate from the expectations, bring losses to the inclusive finance institutions and eventually lead to market risks.

Operational risks include internal and external categories, which are risks caused by internal process, employee errors, system failure or fraud. This type of risk may cause damage to the operation and reputation of inclusive finance institutions.

Inclusive finance institutions may face a wave of customer withdrawal or shortage of funds, which leads to unable to meet capital needs, thus affecting their business continuity and stability and causing liquidity risks. Therefore, inclusive finance institutions must attaches great importance to the problem of commercial sustainability in their daily operations.

With the use of digital technologies such as artificial intelligence and cloud computing in inclusive finance, financial institutions rely on technological infrastructure for business operations, including online banking systems, payment platforms and data storage. Technical failures or information security vulnerabilities may lead to technical risks. Therefore, it is an important task to ensure the application security of digital technology and data privacy is an important task in financial services and risk assessment.

5. Difficulties in the Risk Management of Inclusive Finance

The particularity of the inclusive finance service group leads to its high risks and hidden dangers. Therefore, solving the risk control problem of the inclusive finance well determines whether the inclusive finance can be further developed. However, there are many difficulties and obstacles in the process of the risk management of inclusive finance.

At present, inclusive finance is in the middle stage of development, and people's risk awareness of inclusive finance is still very weak. They do not have enough understanding of the risks of inclusive finance, and there are even some misunderstandings of various risks faced by inclusive finance. With the rapid development of inclusive finance, its potential financial risks will gradually emerge.

In the past decade, the number of inclusive financial institutions is increasing. In addition to traditional financial institutions, there are also Internet companies of various formats that have joined in the practice of inclusive financial business. The large number and types increase the difficulty of risk management of these inclusive financial institutions, and accelerate the spread of risks. And the quality of these inclusive financial institutions is also uneven[2]. Some institutions are committed to providing affordable financial services to help marginalized groups access loans, savings and other financial instruments, and promote inclusive and sustainable economic development. However, some other institutions lack transparency and compliance and fail to truly implement inclusive finance, which deviates from the original intention and essence of inclusive finance.

Influenced by the unbalanced level of economic development in different regions, the development of inclusive finance is obviously different in various regions. The demand of different customer groups and industry categories is also significantly different, resulting in high dispersion of business models and products and services, which is difficult to implement unified management. The uneven product quality is also a major difficulty in the risk management of inclusive finance. Some products on the platform, such as high interest rates, complex fee structure, fraud, etc., may lead customers into a deeper cycle of poverty, rather than helping them out of trouble. Such products are not really inclusive finance products and lead to market chaos and the accumulation of risks.

Risk control is the core of financial institutions to achieve sustainable development of business, but at present, most inclusive finance institutions fail to establish a sound and effective risk control system and thus risk prevention is not in place and risks are easy to accumulate. Because the the service group is mainly the long-tail group, the phenomenon of information asymmetry is common. It is difficult to collect information with accuracy for financial institutions and comprehensively and accurately evaluate the credit status of borrowers. The traditional risk control technology cannot meet the requirements of risk control. The early risk control is therefore difficult and the cost is high. With the application of digital technology in inclusive finance, some inclusive financial institutions may face risks related to technology, because the default cost of digital mode is relatively low and the probability of malicious default increases, such as network security risks, data privacy risks, etc. This not only increases the management difficulty of the risks for financial institutions, but also restricts the healthy development of digital inclusive finance.

Finally, the external development environment of inclusive finance in China is restricted, and there is still room for improvement of regulatory system, which has not reached the original intention of inclusive finance to a large extent. With the development of fintech, new financial business forms continue to emerge, such as Internet finance, P2P online lending, etc. Technological progress has provided a boost for the development of inclusive finance. However, due to the small diversification of digital inclusive finance business, the immature development model and the lag of the regulatory policies of emerging financial forms, the regulatory difficulty is also increasing, and there are likely to be regulatory loopholes. The particularity of inclusive finance requires that we cannot rely on the traditional regulatory model of inclusive finance. Only by establishing a regulatory system adapted to inclusive finance can the regulatory purpose be achieved in a timely and efficient manner. At present, in the process of regulatory system change in China, there is still no thorough statistics, monitoring and assessment and evaluation system of the related indicators of inclusive finance. The relevant industry rules and regulations are being introduced one after another, and the regulatory system is also in the process of gradually improving.

6. Future Directions and Recommendations

In recent decade, inclusive finance has made great progress. However, it is difficult to hide its many problems in the process of its rapid development. Due to the characteristics of inclusive finance itself and the unstandardized regulatory system, inclusive finance risks and problems are more severe compared with the traditional financial risk, especially the credit risk and adverse selection and moral hazard caused by information asymmetry. The development of inclusive finance policy requires a comprehensive strategic framework to ensure the realization of business sustainability and financial inclusiveness, so this study proposes the following policy suggestions from the two dimensions of financial institutions' own operation and government support.

First of all, for financial institutions, the risk control system should be improved through the combination of inclusive finance and digital risk control. The development of inclusive finance cannot be separated from the innovation of risk management. Digital risk control, by using big data, artificial intelligence and other cutting-edge technologies, can predict, identify, evaluate and manage financial risks. It effectively improves the efficiency and accuracy of risk management. According to the Fintech Development Plan (2022-2025) issued by the Central Bank of China, financial digital transformation has become a necessary measure to improve the operating efficiency of financial institutions and meet regulatory requirements, and will provide solid technical support for the sustainable development of inclusive finance. Inclusive financial institutions should actively apply digital technology such as big data technology to the day-to-day business. This will help strengthen the integration and application of data and establish a unified credit system. It is convenient for financial institutions to fully grasp the information of long-tail customers represented by small and micro-sized firms and successfully reduce the risk caused by information asymmetry.

In addition, the cooperation between financial institutions and governments, non-governmental organizations and social enterprises can be further strengthened. Based on the previous analysis of the Brazilian agency banks, it is possible to broaden the channels of inclusive financial services through cooperation and jointly promote financial inclusiveness. For example, inclusive financial institutions can establish cooperative relationships with small and micro-sized enterprises to provide customized financial solutions. Futhermore, the government should actively participate in it and provide policy and capital support to promote the development of inclusive finance.

From the perspective of government, the development of inclusive finance in China is still in the middle stage, but with the strong support and input of the state, there is great potential for the development of inclusive finance. Therefore, the government must strengthen the awareness of risks and dangers of inclusive finance among practitioners and users. Through education and training for inclusive finance practitioners, the risk awareness of inclusive finance practitioners should be improved. It is also neccessary to raise users' general awareness of the risks of inclusive finance through brochures, social media, knowledge contests and other methods, especially for women and rural residents, which contributes to gender equality and rural inclusive finance promotion[3].

The government should also strive to improve the risk supervision system of inclusive finance, which is the most direct way to ensure the healthy and sustainable development of inclusive finance. Drawing on the experience of the World Bank, the G20 and other international organizations, a national and regional statistical and monitoring system for inclusive financial indicators can be established to provide information and data support for the formulation and adjustment of inclusive financial policies. To strengthen laws and regulations, measures can be taken to establish a self-discipline mechanism for the digital inclusive financial industry and formulate internal norms of the industry. In the process of supervision, it is first and foremost to integrate inclusive financial institutions and products completely into the regulatory system, and then the possible illegal behaviors of financial institutions should be supervised and punished to improve the overall quality of the industry.

7. Conclusions

In the modern financial industry, inclusive finance is an effective means to promote economic growth, reduce poverty and inequality and promote sustainable development. However, in order to ensure its sustainable development and stable operation, risk control and regulatory measures also need to be strengthened while promoting inclusive finance. Only by reasonably assessing risks, strengthening financial literacy and awareness and establishing an effective regulatory mechanism, can we ensure that inclusive finance will continiously play a positive role in the financial industry and reduce potential risks.

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