

Development of Industrial Digital Finance in China: Priorities and Policy Suggestions¹

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***Abstract:** As the consumer-oriented internet market saturates, the industrial internet represents the dominating trend of future digital economy growth in China. It is also an ideal position to exert force in driving the innovation, transformation, and growth of the Chinese economy. The close integration of digital technology and financial services in industrial application scenarios provides immense possibilities for further fintech boom and it is an important innovation that empowers finance in supporting the real economy.*

Distinguished guests, dear friends, ladies and gentlemen,

Good morning!

It is my great pleasure to participate in the 1st Greater Bay Fintech Summit. Today, I would like to share some of my views on the development of industrial digital finance.

The essence of the digital economy as a brand-new form of socio-economy is the rapid optimization of resource allocation and regeneration enabled by the identification, selection, filtration, storage, and usage of big data (digitalized

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knowledge and information) by human beings via the consumer-oriented internet and the industrial internet.

We are already seeing the digital economy flourishing in the consumer-oriented internet, where digital tools have prevailed and boosted the efficiency of communication, collaboration, and transaction. But as this market saturates, taking its place is the industrial internet which is an important direction for future digital economy growth and a powerful driver for the innovation and transformation of the Chinese economy.

Most of the top 20 tech companies in China are consumer-oriented internet service providers. In contrast, half of the top tech companies in the United States, such as Microsoft, Cisco, and Qualcomm have already led the industrial internet market. As the tech competition between the two countries intensifies, the industrial internet will be important for China to achieve further progress of its digital economy.

Amid the digital economy boom, the financial sector should also proactively transform. **Industrial digital finance embodies the digital transformation of the traditional industrial financial sector.**

Industrial finance is an important form of financial services, where traditional financial institutions represented by banks focus on serving businesses along the supply chains. We could divide the development of industrial finance into three phases: phase 1.0, where banks concentrate on corporate business; phase 2.0, where supply chain finance upsurges; and the brand-new phase 3.0, characterized by a boom in industrial digital finance.

In phase 1.0 and 2.0, traditional industrial institutions still face severe information asymmetry with a lack of technological capacity which makes it hard for them to get the full picture of the supply chain and the real situation with the balance sheets and potential risks of private and medium- and small-sized enterprises, resulting in their distrust in these borrowers. The fundamental problems are difficulties in identifying their assets and verifying their data, not to mention in real-time, as a result of information asymmetry with regard to the flow of goods, data, and funds along the

supply chains. **Information asymmetry has pushed up the cost of risk that financial services involve, which is the root cause for difficulties and high costs facing private medium-, small- and micro-sized enterprises in obtaining finance.**

Relying on technologies such as the Internet of Things, blockchains, AI, and big data, industrial digital finance realizes the full transparency of information and data upstream and downstream of the industrial chain, making it difficult to tamper with the full chain fidelity; the full penetration of the assets, the real-time tracking of first-hand data; and the real-time monitoring and warning of potential risks. The widespread use of digital technology in the industry chain enables financial institutions to see and manage assets more clearly, significantly lowering the risk cost of financial services. It is expected to facilitate financing for medium, small, and micro enterprises (MSMEs) to obtain inclusive financial services similar to consumer finance. The industry's close integration of digital technology and financial services is the next blue ocean of fintech and a significant innovative application of financial services for the real economy.

I see six major values in China's efforts to develop industrial digital finance:

1. Systematically addressing the financing issues of private MSMEs in the industry chain is an effective way to "protect the industry chain" and "protect market players" during the process of restoring production following the pandemic.

China's State Council has implemented many policies to boost the private economy and assist MSMEs since the outbreak of Covid. Private MSMEs account for 80% of China's social and economic entities, with different industries' most pressing survival and development needs. Specific fiscal and financial support policies should be categorized and implemented. It is especially important at this stage to preserve MSMEs in the upstream and downstream of key industrial chains, whose stable development is critical to industrial chain stability.

Digital technology-enabled innovation in industrial digital finance will digitize and make transparent the business situation of each enterprise body in the industrial chain, allowing financial institutions to directly penetrate private MSMEs that could not

have been served in the past with the help of technological empowerment and provide direct financial services. Instead of phased policy support, industrial digital finance is a long-term "pipeline unblocking" project that, combined with active fiscal and financial policies, will become an effective long-term means of boosting the business vitality of private MSMEs in the industrial chain.

2. Raise the technological level of China's financial services to direct the innovation of financial services from subject credit to transaction credit.

Industrial digital finance, as the 3.0 stage of industrial financial services, makes full use of data that are objective, fair, difficult to tamper with, and widely applied in the era of smart technology, which was difficult to achieve in the previous era of Internet consumer finance and is an initiative to embrace the world's technological development trend and follow the pulse of the times. With the advancement of digital technology, financial services are gradually shifting away from the supply chain finance model, which valued guarantees and collateral for corporate entities, as well as the rights and credit enhancement of core enterprises, and towards one that focuses solely on transaction credit and provides an equal financing environment for market participants.

This represents an opportunity for China's financial services technology innovation to lead the world in a new financial services trend.

3. Cost reduction and efficiency gains, reducing costs as much as trillions of RMB for the real economy.

One of the features of digital technology is that every 1% of small changes can bring about unbelievably huge benefits. According to a rough estimate, the accounts receivable and payable and the stock of fixed assets of the real economy enterprises have surpassed 100 trillion yuan. With the help of industrial digital finance, reducing the financing rate by 1% can help enterprises save financing costs of 1 trillion yuan. This effect can be even more significant in social financing with higher costs of private and micro, small, and medium-sized enterprises.

4. Being important in preventing systemic financial risks.

Technology innovation is often accompanied by high risks, often causing market criticism and doubt. However, industrial digital finance is precisely an important innovation for preventing systemic financial risks. The essence of industrial digital finance is to maximize transparency of all aspects of industrial financial services through digital technology, so that traditional financial risks such as false trade backgrounds, false transaction processes, false capital transactions, false account management, and false data have nowhere to hide. Industrial digital finance can expose and thus reduce all kinds of potential risks in the current financial system through digital means and create a fully transparent digital financial market.

5. Providing regulators with a powerful weapon of digital and technological supervision.

Regulators can also turn to digital technologies to monitor the service process in real-time, and signal potential risks in advance through early warning models based on real-time data. This will significantly enhance China's technological capability for financial regulation.

6. Accelerating the digital transformation of each entity industry and motivating enterprises for transformation.

Industrial digital finance and industrial Internet are the two-wheel drives in the digital transformation of enterprises, which should be implemented together. In practice, enterprises face a time mismatch between huge investments in the short term and a long waiting time before the gains are felt. So SMEs that have been under great operating pressure would find it hard to bear the cost of digital transformation.

Industrial digital finance can be used to facilitate the technological transformation of the industrial internet, so that enterprises can benefit from the actual gains brought by digital financial services in a shorter period of time. This will significantly improve the enthusiasm of enterprises for pushing digital transformation and help integrate the digital economy into traditional industries as soon as possible.

Unlike Internet consumer finance that serves the customers, industrial digital finance that focuses on serving the value chains of businesses must learn from the lessons drawn during the development of Internet finance and insist on the three principles below.

First, we should stick to the principle of letting technology institutions and financial institutions play their due role and complement each other to build an ecosystem. The market scale of industrial finance is several times larger than that of consumer finance, and thus the criteria for services and professionalism would be much higher. Such a huge and complex market cannot be built by tech companies or financial institutions alone, and neither of them can replace the other. Tech companies provide digital technologies, and financial institutions offer services for financial scenarios. When the two play their due role, maintain an open mind, and complement and integrate with each other, innovative services of industrial digital finance can be achieved.

Second, we should stick to a strict entry threshold, draw lessons from the consumer Internet, and steadily promote technological innovation in industrial digital finance. Digitalization of an industry entails demanding technologies, especially to meet the risk control requirements of financial institutions. Industrial digital finance is not a simple system alignment and data collection between any tech companies and supply chain companies. Instead, industrial digital finance needs profound technological empowerment of the whole process of industrial finance to integrate data regarding logistics, the flow of commodities, capital and information. Only platforms and teams with a deep understanding of both finance and technology can establish such an ecosystem. Financial institutions should carefully select technology platforms that have a profound knowledge of both finance and technology and prudently develop industrial digital finance.

Third, we should stick to the goal of helping the real economy reduce costs and increase efficiency. Industrial finance powered by digital technologies must help the real economy achieve lower costs and higher efficiency instead of adding extra

costs of financial services for businesses. Digital platforms should serve as a technological bridge between financial institutions and the real economy.

As for how to develop the ecosystem for China's industrial digital finance, I propose four suggestions:

First, policies should be introduced to encourage businesses to build their own digital infrastructure and grant businesses specific additional tax deductions.

Chinese businesses have a weak digital and information foundation and thus need targeted policy support in the short run. Companies that do invest in digitalization should be given specific additional tax deductions to enhance their motivation.

Second, the People's Bank of China should improve the "sandbox supervision" system, especially to strengthen its support for innovation of industrial digital fintech platforms.

The PBC should provide regulatory endorsement for established industrial digital financial platforms and grant them legal status, encourage banks and other financial institutions to prioritize cooperation with technology platforms, and standardize market entry mechanisms.

Third, regulators including the PBC, CBRC, and CSRC should introduce policies to guide all types of financial institutions to increase the proportion of their digital financial assets,

particularly the share of risk control for the digitalization of existing and new assets, which can help strengthen the tech-empowered risk control ability and asset quality of financial institutions. The regulatory authorities should encourage financial institutions to digitalize themselves in innovative ways and cooperate with authorized third-party technology platforms.

Fourth, relevant departments should launch technological innovation funds to support the growth of companies engaged in industrial digital fintech, enrich technological innovations in the niche areas of industrial digital finance, enhance digital penetration and early warning ability of industrial chains and business assets, to control risks better and enable finance to support the real economy through

continuous technology upgrades.

All in all, industrial digital finance is a new engine for stable economic growth in the future. It requires close cooperation among the government, technology companies, business entities, and financial institutions to build a sound ecosystem that integrates policy, industry, finance, and technology, as well as to establish a clear and unified regulatory system to jointly promote the high-quality development of industrial digital finance.