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Analysis of the Construction of China's Digital Inclusive Finance Supervision System

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Abstract: In the Chinese market, there are many small and medium-sized enterprises with financing needs. Due to existing risk factors and the high cost of physical business outlets, however, financial institutions are unable to serve all those in need. Nevertheless, the total demand of such groups is huge, making the need for finance by the SME(small and medium enterprise) community cannot be ignored. This thesis adopts the method of literature analysis and review to mainly study what kind of problems will be encountered in the process of using digital technology to realize financial inclusion in China, and how the regulators and policymakers should manage the risks and formulate relevant policies in light of China's national conditions, so as to enable financial institutions to develop digital financial in a viable and effective way, and ultimately achieve the goal of providing financial services to all groups in the social strata at a low cost. This thesis finds that while strengthening regulation of digitalization in the financial sector in order to reduce risks, it is important to realize that the current lax regulatory environment is one of the key reasons for the rapid development of digital finance in China and that policymakers should weigh the pros and cons and find a compromise in the policymaking process.

Keywords: digital inclusive financing, regulating, supervising system

1. Introduction

In recent years, the rapid development of digital inclusive finance has greatly solved the problem of information asymmetry and risk mismatch, drastically cut down the operating costs of financial institutions, and well alleviated the increasingly prominent contradiction between supply and demand in China's modern financial services industry. Many studies on digital financial inclusion have pointed out the significance of digital financial inclusion for China's development path and put forward suggestions for further development. However, these articles have little to say about how to do a good job of regulating digital financial inclusion in the current start-up phase [1]. It is very important and complicated to grasp the strength of regulation in the field of digital finance; if the regulation is too loose, it will generate more risks, and if the regulation is too harsh, it will discourage financial institutions from innovating and reduce the efficiency and effectiveness of the development of digital inclusive finance in China [2-3]. This paper adopts the method of literature analysis and review, mainly discussing how the regulatory system of digital inclusive finance should be

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constructed. This study can provide references for the formulation of relevant laws and regulations, which can better maintain the vitality of the fintech sector while reducing the related risks.

2. The Concept of Digital Financial Inclusion

Digital financial inclusion is a combination of the concepts of financial inclusion and digital finance. The core of financial inclusion is the effective provision of financial services to all social classes and groups. Due to China's large population base, the number of potential customer groups for financial institutions has increased, and a comparable proportion of them are micro and small enterprises, start-ups and growth enterprises. Therefore, one of the key objectives in realizing financial inclusion lies in how to reduce the variable cost of each financial institution's business. Infrastructure such as big data and cloud computing in digital finance can provide financial institutions with a digital footprint of potential customers at a lower price. And, by getting rid of the long-tail effect caused by physical locations, the marginal cost of serving new customers can be reduced to almost zero. The advantages of digital platforms can effectively reduce financial institutions' operating costs and enhance information transparency. However, the virtual nature of digital finance can also pose other risk issues.

3. The Necessity and Feasibility of Developing Digital Inclusive Finance in China

3.1. Analysis of Necessity

First of all, as a large country with a large population, China has a large number of SMEs, compared to the number of financial service institutions, which makes the trend of oversupply in the traditional financial service industry more and more obvious, and the contradiction between the various sectors of the society and the financial institutions is becoming more and more prominent. According to the tax declaration data of the State Administration of Taxation of China, as of the end of September 2024, there were 81.56 million small and medium-sized enterprises and individual industrial and commercial households, accounting for 96.5% of the total number of business entities in the country, which is higher than the global average level. Whether from the perspective of individuals' financing needs, financial institutions' profitability and the country's economic development, the needs of these huge numbers of potential customers cannot be ignored.

Moreover, inclusive finance can help narrow the gap between the rich and the poor and help realize the Chinese dream of common prosperity [4]. From historical data, it is known that financial institutions always tend to provide financial services to large companies with good reputations, while small and medium-sized enterprises find it difficult to obtain services provided by financial institutions; therefore, when facing the same economic environment, large companies will get out of trouble with the help of financial institutions, while other companies are not so lucky. The realization of inclusive finance makes it easier for smaller enterprises to easily access the financial institutions' financial support as well, solving the problem of financing difficulties to a certain extent, helping them get through the development and maturity period faster, turning losses into profits or realizing higher profits, improving the income of employees, and reducing the income disparity between large enterprises, small and medium-sized enterprises, small and micro-enterprises, so as to reduce the gap between the rich and the poor [5-6]. According to Peking University's Digital Inclusive Finance Index, individuals and businesses in central and western China use mobile devices less often for payments and have more difficulty obtaining financial services such as loans from financial institutions than those in the southeastern coastal region, which has led to the economic growth rate of some inland cities in the west to be much lower than that of coastal cities in the east, a gap that is narrowing with the development of digital inclusive finance in recent years [7]. The growth of digital inclusive finance can be seen in the increase in the size of loans in China from year to year. By the end of 2023, the balance of inclusive microfinance in China will be 29.4 trillion yuan, an increase of 23.5% year-

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on-year, with an annual increase of 56,100 yuan, or an additional 10,300 yuan year-on-year. Financial services are trying to integrate different scenarios and provide funds for the diversified needs of different groups in society, which to a certain extent alleviates the problem of financing difficulties for small-scale organizations such as SMEs, drives the development of them, and improves profitability [8].

In addition, China's fintech sector and digital payment technology are globally influential, and China should play a leading role in exploring and innovating in the fintech sector to provide practical experience for other countries. According to a report jointly released by KPMG and H2 Ventures, an Australian fintech venture capital organization, 22 companies from the Asia-Pacific region will be on the list of the top 100 global fintech companies in 2022, with China accounting for seven of the companies. According to the People's Bank of China, by the end of 2023, China's mobile payment penetration rate had reached 86%, ranking first globally, and the scale of mobile payment transactions for the whole year of 2023 exceeded 555 trillion yuan, with an average annual growth rate of more than 64%. This means that China's financial institutions have accumulated a considerable amount of user information, and this number continues to grow at an alarming rate each year. The accumulation of massive raw data is necessary for the development of digital inclusive finance. It can be said that China possesses the prerequisites for the development of digital inclusive finance and the ability to match them. In the world. There are very few countries that have these two elements at the same time. Therefore, it is an unstoppable trend for the Chinese to develop into the field of digital inclusive finance.

3.2. Analysis of Feasibility

The popularity of mobile payment in China is high, and the rapid development and popularization of digital technology are conducive to collecting users' digital footprints. As of the third quarter of 2024, the size of China's mobile payment users exceeded 850 million, and the mobile payment penetration rate was about 86%, ranking first in the world. In 2023 mobile payment market size reached 55 billion yuan, and non-bank payment institutions processed more than one trillion transactions. These data help form a comprehensive database that helps financial institutions better understand potential users' credit, family status and other basic information, and helps determine the reliability of users. Financial institutions can access and analyze the relevant data to analyze how to provide services to customers with different conditions. In addition, the high-speed development of the Internet allows digital financial platforms to serve more customers at the same time, reducing the labor costs of brick-and-mortar financial institutions and saving customers time waiting in line. Thanks to digital platforms, the marginal cost for financial institutions to serve each customer is almost zero, allowing the needs of more customer groups to be met.

The current loose regulatory environment in China is conducive to financial innovation. As the digital financial sector is still immature, the formulation of many relevant regulations is still in the exploratory stage, which provides financial institutions with more room for maneuver, and coupled with the current incentives for the development of digital finance, China's digital inclusive financial sector has been able to develop rapidly. For example, the lowering of access thresholds means that financial institutions do not have to expend a lot of energy to deal with cumbersome approval procedures, and can apply more resources to research and development, and in the process of product design, the lowering of compliance costs can be used to save money for research and development expenditures, etc., which encourages financial institutions to innovate with vitality and motivation, and there are also other aspects, such as protecting the results of innovations, encouraging the entry of new participants, and promoting cross-border cooperation, etc., can also promote financial institutions to develop more varieties of financial products for customers to choose.

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4. Current Status of Digital Inclusive Finance Regulation at Home and Abroad

The People's Bank of China (PBOC) has taken the lead in the development of digital RMB, leading China's digital financial development into a new phase. The central government promotes the development of digital finance by strengthening the popularity of digital currency and encouraging local pilot areas to test innovative applications of financial technology. Meanwhile, relevant laws and regulations are being gradually improved. Since 2010, with the explosive growth of Internet financial business, a series of regulatory policies have been introduced, and corresponding management measures and guidelines have been issued in various fields such as electronic payment, financial regulation and consumer protection, which have jointly laid the foundation of the legal system within the digital financial industry. After 2020, *the Cybersecurity Law, the Data Security Law, and the Personal Information Protection Law* have been implemented to regulate the collection and use of electronic data, providing legal protection for data security and user privacy. *The Sixth Five-Year Reform Program* of the People's Courts promulgated by the Supreme People's Court proposes to improve the rules for adjudicating financial disputes in emerging areas, such as digital currency, internet finance, and cross-border investment and financing, within five years. It establishes perfect judicial procedures. In November 2024, the *Action Plan for Promoting High-Quality Development* of Digital Finance, jointly issued by multiple departments, specifies a development plan for multi-departmental cooperation to accelerate the digital transformation of the financial industry. Overall, as China's digital inclusive finance is in the early stage of development, the relevant laws and regulations are relatively imperfect, and the existing laws and regulations and policies are based on guidance, standardization and encouragement, and the overall regulatory environment is relatively lax, which leaves a large operating space for the innovative development of digital finance. e.g., in the Action Program to Promote the High-Quality Development of Digital Finance issued by the People's Bank of China in 2024, it was proposed that it should improve the financial governance system, strengthen digital financial risk prevention, enhance digital financial risk supervision, improve financial consumer protection mechanisms, protect consumer rights and interests, and put forward the principle of "penetrating supervision" to prevent financial institutions from circumventing the existing regulatory system through complex business structures and innovative mechanisms. Such policies reduce risks while reasonably ensuring the vitality of financial institutions.

Around the world, the regulation of digital inclusive finance in many countries and regions is also led by central banks or traditional financial regulators such as the CBRC and CIRC, which are responsible for the approval, supervision and management of digital financial business, forming a relatively standardized regulatory system. The U.S. amendments to the *Bank Secrecy Act and the Electronic Funds Transfer Act* have strengthened the regulation of digital payments, and the EU's Payment Services Directive 2 specifies the entry thresholds, operating norms and other requirements for digital financial business. Multi-sectoral supervision is the development trend of the regulatory system, with tax, industry and commerce, communications and other departments synchronized to participate in the supervision, and more in-depth and effective supervision of the overall industry is carried out through the collusive relationship of data between various departments.

5. Suggestions for Strengthening the Regulatory System of Digital Inclusive Finance

China's digital inclusive finance has been able to develop rapidly in recent years due to a lax regulatory environment, which also brings more risks, such as the accumulation of systemic risks. Therefore, policymakers should be deeply aware of this issue, balance the pros and cons, and minimize the regulation of digital finance on the premise of reducing risk factors to an acceptable level, so that the market can function more completely and effectively.

Policymakers need to be deeply aware of the importance of a relaxed regulatory environment for the development of the financial industry, as well as the importance of digital financial inclusion for the country as a whole and for individual residents, and changes to the regulatory system in the field of digital finance should be made in a gradual and orderly manner, with innovations made from the micro to the macro level, and from the local to the overall level, in order to ensure that the market has sufficient time to react; secondly, when formulating policies policymakers couldSecondly, policy makers can consider multiple opinions, such as public opinion surveys and other forms of obtaining feedback from different social groups; and, policy makers can study the problems exposed during the application of digital finance in other countries, analyze or find solutions, and reasonably refer to the relevant laws and regulations of foreign regions, so as to form a digital financial regulatory system that meets the needs of China's social development.

6. Conclusion

This essay mainly discusses how regulators should formulate laws and regulations for digital inclusive finance based on the benefits and risks brought by the virtualization and other characteristics of digital platforms, so that the concepts of digital finance and financial inclusion can be better combined and complement each other's strengths and weaknesses. This study concludes that when formulating a regulatory system for digital inclusive finance, regulators should have an in-depth understanding of the two-way effects of the regulatory system, and can draw on the relevant laws and regulations of other countries and combine them with China's national conditions to formulate an appropriate regulatory system for China. This thesis does not combine data and empirical evidence to study the impact of the existing financial regulatory system on the financial market. In the future, the relationship between regulation and financial innovation ability can be studied through mathematical modeling.

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