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China's emerging credit culture

Consumer credit is largely unknown in this market of 1.3 billion people, and the Chinese have been slow to adopt the use of non-cash forms of payment. All this will soon change, however. This financial services executive explains why.

With 1.3 billion people—a fifth of the world's population—in China, the question on many senior executives' minds is: When will the Chinese consumer buy my products and services?

Consumption is, of course, dependent on a number of variables, which can be boiled down to: Do they want to buy what I have to sell? Are they able to buy what I have to sell? The desire to buy and the ability to pay are at the heart of Leeahun Lee's mission as Visa's chief representative and vice president for China. Just 12 years ago, there was not a single Visa-card holder in China. Today, Visa boasts 30 million of them.

Lee arrived in Beijing from Visa corporate headquarters in San Mateo, California, in 1994 to head up the company's cooperative effort with China's Golden Card project, a program launched by the government to improve the country's payment-system infrastructure. The goal: 200

million bankcard holders by 2003. Two years later, Lee was tapped to lead Visa's entire China operations.

Under his watch, Visa has worked with various local institutions to further the development of a payment infrastructure in China. For example, Visa provided professional advice and recommendations on the operations, structure and technical equipment necessary for the successful operation of China's first electronic payment network. In addition, with the People's University of China, Visa established a credit-card research and training center to provide professional training to personnel from local banks.

A Taiwan-born Chinese who pursued industrial engineering and M.B.A. degrees in the United States, Lee believes that being an ethnic Chinese has been an invaluable asset in developing rapport and understanding with his Chinese counterparts. In particular, he has drawn upon his practice of the ancient Chinese exercise, *taijiquan*,

also known as shadow boxing, to guide him in meeting the unique challenges of the Chinese market.

Beijing-based writer Charlene Fu recently spoke with Lee in his office about the payment-system infrastructure in China—where it is now and where we can expect it to go in the next three to five years.

Outlook: In order for credit cards to play a significant role in a country's payment system, there has to be a tradition or culture of credit. What is the attitude toward debt in China?

Lee: The savings rate in China is 40 percent. This is an indication of the consumers' attitude toward credit. Chinese rarely borrow for consumption. They will borrow only if they have to.

Why is there this aversion to debt? China historically has been less stable than other markets. Also, con-



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sumer confidence is lower than in the U.S., for example. Therefore, the comfort level for borrowing is lower. Chinese people have a stronger desire to put money aside for the future.

What about lenders?

You have to understand the Chinese banks' mentality: They want zero risk. They don't necessarily care about high profitability. And there's the shame element, too. What if you give someone a credit card and he turns out to be a bad credit risk? Local bank management tends to focus on the one bad card that the bank issued, even if there are no problems with all the other cardholders.

And the government?

The government is quite conservative in terms of lending to individual consumers, and that can have the effect of deterring consumers from borrowing. People basically have four types of financial needs: emergency, short-term consumption, long-term expenditure and investment. In China, the source of financing retail purchases—that is,

short-term consumption—is primarily cash and a little borrowing.

Is this attitude likely to change?

Yes. The trend now is toward encouraging more consumption, thus more short-term borrowing. For instance, housing loans and auto loans were launched in Shanghai and Beijing recently. People can also borrow small amounts using their savings deposits or government bonds as collateral. There's more and more talk about promoting consumption at the consumer level. That will promote consumer lending at the bank level because it is a profitable business. And as the economy changes and business activities increase, people will find that borrowing is a way of enhancing your earning power and upgrading your lifestyle.

What are the implications in all this for credit-card issuers?

First of all, let me clarify "credit cards." I like to use the term "payment cards." It's a payment mechanism. From the merchants' perspective, the main concern, when a customer pays



with a card, is whether he will be paid, regardless of whether the cardholder borrows the money or whether it's real money in their checking or savings account. It is Visa's mission to become the world's best way to pay or to be paid. So from that perspective, I don't want to limit China's payment-card business to just the credit card. In China, Visa has launched deferred-debit cards and debit cards—whatever the market needs. Reflecting the Chinese people's preference not to borrow and local banks' policy of zero risk, the debit card is much more suitable and popular than other types of cards in China.

How widespread is the use of cards?

The card-payment industry has been experiencing surprising growth during the past five years. The cards in use numbered less than 10 million five years ago. Today, there are more than 100 million payment cards out there, including 30 million Visa cards, 20 million other international payment cards, and 50 million local brand cards. And to

double that, I think three years will be enough.

But are the cards actually being used?

Acceptance and usage is the key challenge for the industry. But we believe the card is the future, a major way of payment. It's an inevitable trend. For now, however, in 1997, only 3 percent of consumer payments were made by card, the rest by cash. However, we anticipate that the cards will probably account for 15 percent to 20 percent of consumer purchases in five years.

What is the ratio of debit cards that have been issued by Chinese banks to true credit cards?

In 1997, 30 million cards out of 70 million cards issued were deferred-debit cards. In China, this means that to open an account, the cardholder has to have 10,000 renminbi [about \$1,200] as a secured deposit, which gives the cardholder spending power of 8,000 to 10,000 renminbi. The secured deposit earns interest, but the spending costs interest, too. And the spending does not come out of the secured deposit; that's a protection for the bank.

And the other 40 million cards issued by banks in 1997?

These are debit cards, which are linked to a bank account. You must have money in the account in order to use the card, but you can have as little as 50 renminbi to get a card. Of course, you can only spend as much as you have in the bank. There were another 30 million cards issued in 1998, and all of them were this kind of debit card.

So how many true credit cards were issued by Chinese banks?

I don't think there are many.

When do you think Chinese banks will start issuing true credit cards?

Banks should already have enough information about their customers from their spending and payment habits with their debit cards to know who would be a good credit-card holder. Over the next 12 months, we should see the issue of true credit cards.

Why has it taken China so long to embrace bankcards?

Banks began issuing cards in 1986, but the cards could not be used cross-bank: A Bank of China card had to be used at a Bank of China merchant. That was very inconvenient for the cardholders. To use my card, I first had to make sure the merchant accepted my card.

From an investment perspective, each merchant had to get multiple terminals. If I wanted to accept Bank of China, Industrial and Commercial Bank of China and China Construction Bank cards, I had to acquire their terminals. So if you went to Yansha department store in Beijing, you would see terminals piled up. It was really very cumbersome and tedious for the clerk and very confusing for the cardholders. And the investment for the banks was very high.

Are things any better today?

There are more than 12 local networks existing in the major coastal cities—Beijing, Shanghai, Guangzhou, Shenzhen and so forth. Within those cities, cards can be used interchangeably, terminals can be shared. But depending on the area, the sharing is not completely established as yet. It requires a lot of coordination and cooperation among banks. Shanghai probably is the most cooperative, most advanced environment.

So technology is not the reason the bankcard infrastructure is still underdeveloped?

It's business—competitive reasons,

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protectionism, trust in the interchange. And the cost: To join a local Golden Card network, you have to pay \$500,000 to \$1 million. We're talking about a dozen cities or provinces that each have a Golden Card switch. So it is very expensive for a bank to join all the switches. In addition, you also have to pay transaction fees.

Does this represent an opportunity for Visa?

Yes, that is why Visa came in. Our confidence in the China opportunity lies in the great potential for the payment industry to grow. Visa is also confident that we can provide the most cost-effective and efficient mechanism for China to develop the card business with a minimal investment. Visa will continue to share the latest technology and knowledge with China and to provide value-added services.

However, the bigger opportunity for Visa and China will come when renminbi becomes convertible. Today, a renminbi-denominated card issued by a Chinese bank cannot be used outside the country.

Presumably, this, too, will change over time.

Yes, but nothing can change overnight. As long as China wants to be a world financial and economic player and to become a member of the World Trade Organization, the renminbi will have to become convertible; then all these cards will become internationally usable cards. At that time, the networks will start competing on a cost basis, on efficiency and effectiveness.

The government says it wants 200 million bankcard holders by 2003. Why?

The central bank wants to promote cards, number one, because cash is

not doing the job. Cash costs a lot of money to print, to recirculate. Criminals are getting better at counterfeiting cash. Number two, cards allow you to capture a lot of information, and it's the Information Age in China. And third, a lot of functions that cannot be done by cash can be fulfilled by chip cards. One of the projects that Visa is working on is for drivers to have a chip card that contains driver information, enabling the cardholder to pay his or her fine or fees through their card.

And consumer?

I just attended a ceremony where China Construction Bank was issuing cards to every government worker in Shanghai who has a housing fund—a fund that the government gives workers to purchase a house. This will enable the cardholder to go to the ATM to withdraw cash, check their housing fund balance and, even more, to go to a merchant and use the card to make purchases.

The Chinese can be very creative, as you can see, in terms of mobile phone usage. Look at the microwave oven: They don't buy an oven, they jump directly to the microwave. It will be the same with cards. The Chinese don't have checks, they have nothing but cash. Cards are going to play a very important role—not just in the urban area but in the rural area as well—for payment, becoming the day-to-day payment tool.

What are the remaining hurdles to wider card acceptance?

To increase acceptance, the banks need to get more merchants equipped. You need terminals, you need to have PIN pads, you need to have networks in order to accept the cards. And also risk management: From the banks' perspective, the more cards there are out there, the more risks there are for them to con-

trol. But things are improving—from the risk management perspective, from the cardholder/merchant quality perspective, from the functionality perspective.

What kind of restrictions has the government placed on the industry?

The government has set the market interest rate prohibitively high. It's progressive. The cardholder has to pay an annual interest rate of 55 percent if the payment is made within 15 days; the interest rate goes up to 110 percent if the cardholder pays within 30 days. The interest rate is 165 percent if the payment is made after 30 days.

Do these limitations detract from what Visa is trying to achieve in this market?

From the economy's perspective, the rate, the price, should be determined by the market, by the competition. Services and products are different, and rates should reflect these differences. The Western world is different from China. In China, things don't happen overnight. You have to find a balance somewhere. We are in dialogue with the central bank. I think they are listening, and they are in the process of issuing new regulations.

What is the biggest challenge you face doing business in China?

It is about dealing with local concepts and the relationship between competition and cooperation. Due to historical reasons, Chinese can be skeptical of foreigners. As such, when Chinese see that foreign service providers have been flooding into the market, it really requires adjustment for the Chinese to understand that competition is healthy and that competition can coexist with cooperation. This concept also accounts for the fact that when China began issuing cards in 1986, cards could not be used cross-bank.

Visa was initially seen as an outsider, seen as a company, like any other company, trying to make money out of China. Rather than a win-win mentality, we faced a win-lose mentality. The other obstacle is that financial data is very sensitive information for Chinese.

Knowing what you know now about China, what would you have done differently?

Do you know taijiquan? It is very different from boxing, from tae kwon do. In taijiquan, you find the opportunity to best utilize your force. You don't go head-on. Taijiquan is very smooth. If I had it to do over again, I would do more taiji style than boxing style. We tried to impose our opinion on the industry. I think we should have taken a more patient approach—let it run its course. Don't try to say, "This is the right way," even though it may be the right way. Initially, we pushed too hard, and we got strong resistance. In China, you should do it the taiji way, which transforms confronting and opposite forces into coordinative and favorable forces.

How will you measure your success here?

For the entire population of 1.3 billion to have a payment card is not that remote. But 1 billion cards would be quite an accomplishment, so I would be quite happy with that. ■

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