Empirical Research into Investment Models in Urban Households in China

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Abstract

In the preparation of this paper, a series of literature-based searches uncovered how urban residents invest for their households and what problems exist today in that area in China. Based on that research and the analysis thereof, the author attempts to discover the reasons attributable to that situation and finally put forward some new models by which Chinese urban residents can manage their finances.

Key words: questionnaire survey, household investment, investment tools, investment portfolio, China

1. Introduction

Along with China's reformation and opening up over the past 20 years, China continues to enjoy a high rate of economic development. Urban residents' living standards have risen gradually, going from being a "basic need" type to a "well-off standard" type and finally a "rich" type, and they have accumulated a certain amount of funds. Along with deep economic restructurings — such as reforms in social security, education and housing — guaranteed programs originally offered by the government and various organizations (including jobs, housing, medical care, retirement pension, and education for children) have been transferred to China's residents, who undertake all or some of the inherent financial risks. Additionally, with the development of China's financial markets — especially of its stock and insurance markets, and personal credit banking — residents have more and more investment channels by which they can manage money or their household finances. In recent times, these issues have become increasingly important matters in residents' lives, in that people have been forced to consider not only how to maintain and increase their on-hand financial assets, but how to better use those fund to improve their living standards.

In preparing this paper, there was an analysis performed of the results of a questionnaire that examined urban residents' investment situations, their perceptions thereof and their levels

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of education. All of these matters were examined in the context of investment risk in China; the paper goes on to point out the current problems with residents' present-day investments, and finally suggests some types of investment. This information is provided in terms of types of household, and is appropriate for urban residents in China when making investment decisions.

2. Investigation targets and method

The investigation targets of this study program were selected according to the Zone regions of Wuhan city in China. Two thousand households were selected from medium-income household section of the population. The sample proportion that came from the Hankou, Wuchang and Hanyang districts comprised 40 percent, 30 percent and 30 percent respectively. 1,570 copies of effective questionnaire withdraw, which accounts for 78.5 percent.

The questionnaire was divided into three parts. There were 36 questions in Part one, including situations concerning urban households' adoption of various kinds of investment products; there were seven problems in Part two, designed to test the urban households' perception and bearing ability of investment risk; and five problems in Part three which captured background data on interviewee, including gender, age, education, annual income and occupation.

The questionnaires were distributed all at one time and collected simultaneously. To guarantee that the sample was representative, we distributed them proportionately according to area, while controlling for annual income and gender distinction — that is, we made sure that 90 percent of the sample households had an annual income of less than 100,000 Yuan and that 10 percent had more than 100,000 Yuan. We also tried to make sure that the number of male interviewees was equal to the number of female interviewees (the final male-to-female ratio was 57:43). Finally, after the questionnaires were collected, we used SPSS statistical software (v11.0) to conduct data processing and statistical analysis.

3. Current situation and analysis of urban household investing in China

3.1. Current investment vehicles

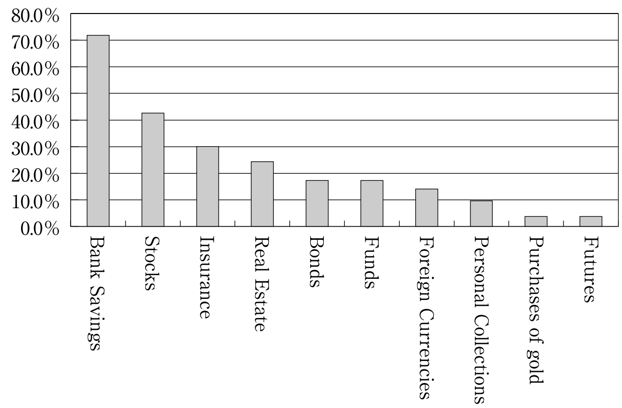
At present, there are generally 10 kinds of investment vehicles that the urban residents in China use: savings, stocks, insurance, real estate, bonds, funds, foreign currencies, private collections, purchases of gold and futures. The distribution of resident property in terms of these investment vehicles is displayed in Table 1 and Chart 1.

As we can see from Table 1 and Chart 1, the most frequently-used vehicle is bank savings, with 71.8 percent of the urban households using it. The secondly most frequently-used vehicle is stocks (42.6 percent). The use of insurance and real estate also boasts a large number of users, in terms of overall population. Gold and futures are scarcely used and

Table 1. Percentage (%) of urban Chinese households within sample using investment vehicle, by vehicle

Investment Variety	Bank Savings	Stocks	Insurance	Real Estate	Bonds	Funds	Foreign Currencies	Personal Collections	Purchases of gold	Futures
Adoption Proportion (%)	71.8	42.6	30.1	24.4	17.3	17.3	14.1	9.6	3.8	3.8

Chart 1. The situation of households' use of investment vehicles



consequently have the lowest user-percentages.

(1) Bank savings was still the urban residents' most frequently-used investment vehicle in China. In the distant past, because the variety of investment products was limited and the choices available were narrow, residents could depend only upon the banks for financial management. Even as choices have diversified, the habit of investing in bank savings has persisted. In addition, as deposits have no risk for fixed income, it is always esteemed by investors and has the most widespread customer group.

(2) Stocks have become the new investor favorite. Although stock investments have not exited in China for a very long time, 42.6 percent of urban Chinese households adopt this investment vehicle because of its high-income, powerful mobility and maneuverability characteristics, among others. It has rapidly attracted the attention of many investors and become an investment "hotspot." In its initial period in China's stock development, related laws and regulations were imperfect; for this reason, investors invested heavily on account of speculation. With the maturity of the stock market and the ability of the legal system to supervise and manage strengthening, stock investment are tending to become, more and more, the rational choice among investors.

(3) "Insurance consciousness" is gradually permeating households in China. A little under one-third (30.1 percent) of city households have purchased insurance. Insurance has a dual effect, in terms of safeguarding the household acting as a financial investment. Insurance types vary greatly; households can choose what is suitable according to their own special details and investment wishes. In recent years, with people becoming savvier about preventing and planning for future calamities, households in China have come to purchase more and

more into every kind of insurance.

(4) Real estate investments have enjoyed a vigorous and flourishing growth. Real estate is a high-investment, high-income field. It can satisfy a household need for housing, while at the same time insuring incremental value. It is a good investment vehicle for countering inflation. Along with deepening housing system reforms in China and the financial organ providing individual housing credit further consummate, real estate investments have become a more regular feature of Chinese urban households.

(5) Bonds have held the confidence of investors for a long time. Bond distribution in China is usually guaranteed by the government, and the credit rank is extremely high. National debt is an investment "hotspot" in which investors are investing. It not only lacks risk but is also exempt from interest tax. Even when the inflation rate is very high, besides a guarantee of fixed income, the government can give bond investors correspondingly the original values, preserved by a subsidy according to the inflation rate. The circulation of national debt is limited, however, and so investors have very little "wiggle space" for making choices.

(6) Mutual funds development is on the upswing. The mutual fund is a tool that is currently extremely popular throughout the world. Through it, a diversified investor's funds are accumulated and handed over to an expert to manage; it can effectively enhance investment benefits and reduce risk, as if there were truly a passive income or "money giving birth to money" effect. But mutual fund development in China has been only a recent phenomenon, and has not yet been embraced by the majority of investors; therefore, at the present time, the user-percentage rate of this kind of investment is low.

(7) Foreign exchange investments have had a narrow margin of development. Foreign exchange transactions are one popular kind of investment in western nations, but this kind of investment has just started in China. Thus common-people investors are quite unfamiliar with foreign exchange investments; also, because China has stricter foreign exchange controls, for common households, foreign currency trading has not been an open option, resulting in a low user-percentage rate in this category as well.

3.2. Analysis of the status quo of investment tactics

Investment strategies used by urban residents of China include both single-and multi-variety investment strategies. Table 2 outlines the number of investment vehicles that each investor tends to use, and the proportion of the nine highest kinds of vehicle for investing in the present stage.

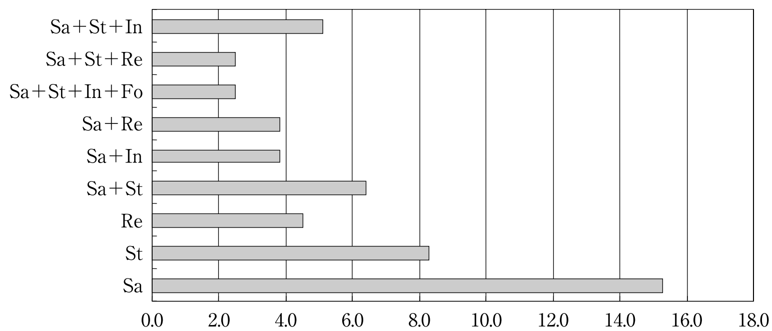
From Chart 2, we can see several important facts as follows.

(1) About 32.5 percent of households use a single-variety investment strategy. The investments with the highest user-percentages are bank savings deposits and stocks, which are used by 15.3 and 8.3 percent of investing households in urban China, respectively. Savvy investors know not to "put all eggs into one basket," for doing so cannot effectively reduce risk and enhance income growth. For instance, if a household were to put all its investment funds into stocks, although stock income might be high, it also carries high risk; once the market becomes bearish, the fund will decrease in value. This would not only cause heavy losses in

Table 2. Number of investment vehicles used per investing household

Number of investment vehicles	1	2	3	4	5 or more
Percentage (%) of households	32.5	24.2	19.7	16.6	7.0

Chart 2. Nine investment combination used with the highest proportion



Note : "Sa" stands for "Savings," "St" stands for "Stocks," "Re" stands for "Real estate," "In" stands for "Insurance" and "Fo" stands for "Foreign exchange."

household funds, but can severely affect that household's daily life. On the other hand, if funds are saved exclusively in the bank, although there is no risk, only minimal (if any) income will be realized; the household will be unable to reach any financial goals it has made in terms of increasing value or income.

(2) Most households make use of Portfolio Pattern investment tactics. Among these households, 90 percent choose a portfolio composed of two to four kinds of financial products — a combination which can often be described as one involving "bank savings plus other products." Under this tack, the investor retains one part of the funds in a bank account in order to meet the household's daily expenditures; another part is put into stock, for example, with the expectation of obtaining high income. Returning to the above-mentioned metaphor, this kind of investment puts "eggs into the different baskets." This investment tactic can disperse investment risk under a fixed income. The pattern of "deposit plus stock" is used by the highest number of households, among those that use multi-variety investment strategies.

3.3. Households with different backgrounds have remarkably different emphases on investment

Households with different backgrounds vary in their investment tactics due, to their different financial situations; we therefore analyzed the correlation between investment emphasis and the investor's household background according to census results.

Table 3 shows the following facts.

(1) Residents at different ages have remarkably different emphases on investment. Investors less than 25 years of age who have not yet married basically have low incomes and heavy expenditures; they need to store funds in order to deal with two costs incurred by marriage and housing. They invest mainly in bank savings and funds with steady income.

Table 3. Proportion of investment taken as focal point used in different household (%)

Demographical Features	Group	Fixed Deposit	Stock	Real Estate	Bonds	Funds	Insur ance	Foreign Currency	Futures
Age	(1) below25	20.0	8.6	20.0	8.6	20.0	0	8.6	2.9
	(2) 26 to 35	22.7	25.8	30.36	6.1	6.1	1.5	3.0	0
	(3) 36 to 45	9.4	28.1	28.1	6.3	9.4	0	0	3.1
	(4) above 46	11.1	44.4	22.2	0	0	5.6	5.6	0
Academic Credentials	(1) below junior college	19.0	20.7	27.6	6.9	10.3	0	6.9	0
	(2) undergraduate	18.2	25.8	25.8	7.6	10.3	1.5	0	1.5
	(3) graduate	15.4	15.4	30.8	0	7.7	0	7.7	7.7
Annual Income	(1) below 50,000 Yuan	17.2	22.2	27.3	7.1	8.1	1.0	5.1	0
	(2) 50,000 to 100,000 Yuan	19.4	35.5	22.6	6.5	9.7	3.2	3.2	0
	(3) above 100,000 Yuan	0	16.7	16.7	0	33.3	0	0	33.3

Investors in China between 26 and 35 years old have mostly already set up their own households; as their incomes increase and become steady, they develop the capacity to bear certain risk, so they turn from funds with steady income to stock with high income, and often buy some high-grade goods to improve their quality of life; also, deposits occupy a sizable proportion. For investors between 36 and 45 years old, their children have already grown up, their jobs are steady, and they have accumulated relatively abundant investment experience. For this sub-population, investment ability is strengthened greatly, and stocks and real estate with high income and high risk are key investments. Finally, because investors above the age of 46 have worked for some time and their children are often already independent, they have accumulated certain funds, have fewer financial burdens and have more energy and time to put into researching the stock market.

(2) Residents with different education credentials have different ways of investing. Investors with junior college-level educations and below have relatively weak abilities to bear investment risk. They invest in vehicles with steady income, such as bank savings and funds. Those with more than an undergraduate degree understand the relation between income and risk relatively, and can bear certain risk while pursuing higher incomes; they typically make investments in stocks and real estate. Investors, with graduate-level academic credentials have certain gains in terms of investment, will reduce the proportion of the regular income products, and improve the ratio between investments of product risk accordingly.

(3) Residents with different household incomes have different aims in investing. For low-income households (i. e., those with less than 50,000 Yuan of annual income), economic strength is limited, and therefore choice of investment is limited. They tend to invest in real estate, stocks and bank savings. When annual income is in the middle-income range of 50,000 to 100,000 Yuan, economic strength strengthens, and the ability to resist risk is also strengthened; people in this income range hold a higher proportion of investments with high incomes, like stocks and mutual funds. Investors with annual incomes of more than 100,000 Yuan mainly invest in mutual funds and the futures market.

4. Status quo of household risk-affording capacity

4.1. The result of the questionnaire

Table 4 shows that over the last 20 years, there has been considerable reform and "opening up" in China; urban residents' incomes have generally increased, as have their risk-affording capacities. Their concepts of "investing" have changed a lot and irrational investment has decreased. Household investments have become less polarized (i. e., excessively conservative and excessively venturesome) and more rational (i. e., moderate).

4.2. Different households

Investors at different age levels, educational backgrounds and income differ in risk-affording capacity, as a result of different household asset accumulation and investment goals.

(1) Age. The older one becomes, the weaker the risk-affording ability becomes. Investors who are 36 to 45 years old have the weakest risk-affording ability.

(2) Educational background. As educational background improves, risk-affording capacity increases.

(3) Annual household income. As one household's annual income increases, its risk-affording ability becomes moderate.

Table 4. Status quo of household risk-affording capacity

Household Type	Percentage (%)	Risk-Affording Capacity	Investment Goal
Conservative	12.7	Weak	Capital maintenance and stable capital returns
Moderate	84.8	Moderate	Sharing the long-term capital increment
Venturesome	2.5	Strong	Pursuing the maximum of capital increment

Table 5. Percentages of household by risk-affording patterns, according to age, education and income

Demographical features	Group Distinction	Conservative Pattern	Moderate Pattern	Venturesome Pattern
Age	1) 25 years old and below	5.7	85.7	8.6
	2) 26 to 35 years old	9.1	89.4	1.5
	3) 36 to 45 years old	25	75	0
	4) 46 years old and above	11.1	88.9	0
Educational Background	1) Junior college and below	20.7	79.3	0
	2) Bachelor's degree	6.1	90.9	3
	3) Master's degree and above	0	84.6	15.4
Annual Household Income	1) 50,000 Yuan and below	17.2	63.4	19.4
	2) 50,000 to 100,000 Yuan	0	100	0
	3) 100,000 Yuan and above	0	100	0

4. 3. Problems in the status quo, regarding household risk-affording capacity

(1) Generally speaking, investors are risk-avoiding. Most investors in China are sensitive to even feeble variations in investment value, so if there is a small increase (i. e., of 10 to 30 percent), many will immediately oversell to maintain profits. Similarly, if there is a small decrease in price, they will tend to oversell to maintain their fiduciary strength.

(2) Generally, there is irrational thinking among investors. Following the scenario from above Table 4 and Table 5, if a decrease in value were to surpass 30 percent, investors will usually neither oversell nor buy in, but only preserve their stocks until they increase in value. This is a typical irrational investment action.

(3) Among households of those 25 years old and younger, the proportion of venturesome investors is on the high side, while among the 36 to 45 year-old households, the number of conservative households is on the low side.

(4) Among the residents with junior college-level education or less, the conservative proportion tends to be too large.

(5) Among households with annual incomes of less than 50,000 Yuan, the proportion of conservative investors is on the high side.

5. Issues, and a countermeasure, for present-day investments

5. 1. Three characteristics among investors in today's urban China

(1) Investors excessively rely on bank savings deposits. Deposits have long been considered the safest and steadiest form of investment in China, and it is always the first choice of household investment. The People's Bank of China has cut the interest rate eight times in the last several years; the one-year term deposit, usually called "Golden time for saving," faced an interest rate drop from 11.53percent to 1.98 percent. The current interest rate is nearly zero percent. After deducting interest tax, investors basically reap no benefit from bank savings — and if one were to add inflation to the equation, the "benefit" is actually negative growth. In the view of the fact that its returns are the lowest of the investment vehicles — which is also to say that the time value of the acquired income is the lowest — one could say that investing in bank savings runs contrary to the essence of capitalism (i. e., to pursue and earn the largest financial benefits).

(2) Awareness of the benefits of investing in insurance is weak. For a long time, most investors in China thought that only low-income households and the elderly needed to purchase insurance. This view betrays a basic misunderstanding by the people of what insurance is about. Insurance categories are numerous; there are many kinds of insurance, ranging from the Safeguard pattern to the Saving-and-investment pattern. There are various insurance types appropriate for different households, according to income and age levels.

(3) Investors neglect the true purpose of mutual funds. Financially, young men and high-income household are active and therefore more apt to accept quickly this recent addition to the investment vehicle mix. Most investors, however, know little about mutual funds; when

they do learn about them, they find that the investment procedure is tedious and the fee rates are higher, and so they are usually not very interested in the funds and have no strong urge to purchase them. In fact, for common households in China — which have certain idle funds, and the need to invest but a lack of investment knowledge and experience-experts can help manage an investment mutual fund, which is a very effective method of income-building.

5.2. Two greatest foundations of the finance managing combination

(1) Saving is a precondition for drawing up a valid investment management plan. The bank savings interest rate has already declined to the lowest figure in ages, meaning that acquiring income through high interest has disappeared. Residents should change their invest direction to other kinds of investment, but they still must reserve a portion of deposits in a vehicle with strong mobility. It can be regarded as safeguarding one's quality of life, in two different ways: on one hand, it can guarantee everyday stability; on the other hand, it can provide sufficient capital for other investments. Investors with regular salaries and subsidies can deposit a portion thereof in current bank savings for daily expenses, while another part can be saved for large future expenditures or investment purposes. For the irregular bonds, the household can save them in either current-or fixed-income accounts, in case of an emergency.

(2) Insurance is a foundation for drawing up a valid investment management plan. In daily life and work, everyone faces many inevitable risks, such as the risk of suffering from arguments and diseases, losing the ability to work, dying prematurely, and so forth. If one lacks the foresight to preclude such risk, once risk becomes a negative reality within the household, that person will urgently require a large amount of funds — a need which wreak spiritual and economic havoc upon the household. If one considers risk in advance and prepares for it by investing in insurance, however, insurance compensation in the event of a calamity will lighten the burden of the household, even if that loss is irrevocable. Therefore all households should purchase insurance, in some amount, to defend themselves from certain risks. For households with low incomes, they should purchase healthcare and accidental injury insurance; high-income households, on the other hand, should purchase property insurance and dividend insurance that can serve both investment and insurance functions. Young people can purchase accident insurance or endowment insurance, with an eye to saving money, while the elderly should purchase medical treatment and endowment insurance.

5.3. Five suggested types of investment combination

The above results are summarized as follows. The choice of the types, control of risk, and the amount of money that can be invested are the three key points to consider when drawing up a valid investment plan in China. The household investment combination should be three combined Patterns organically. Because residents' investment behaviors are closely related to age, household annual income and education background, we put forward five investment combinations, tailored to groups that differ in terms of these three criteria.

(1) Savings + insurance + national debt + income funds.

Chart 3. The combined model for low-risk and fixed income growth

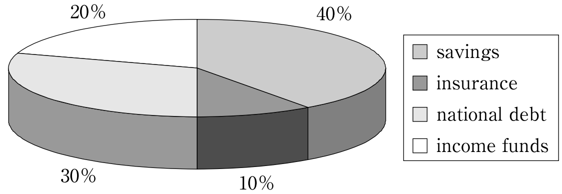


Chart 4. The combined model for low-risk and growth funds

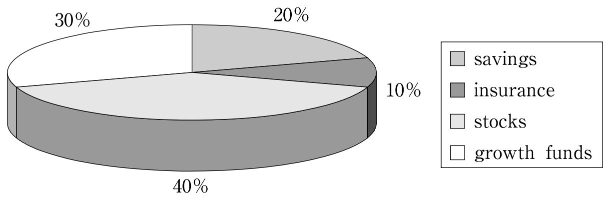
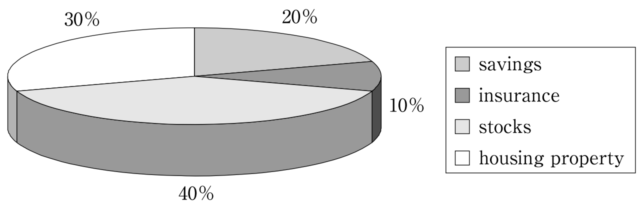


Chart 5. The combined model for positive increasing income



The investment proportion of this combination is 4 : 1 : 3 : 2. This combination is suitable for residents aged 25 years or less, with an annual income of 50,000 Yuan or less, and with a relatively low level of formal education. The investors in this life-stage are unmarried, with low incomes and a large expenditures. Although they may have strong adventurous spirits in their everyday lives, their capacity for risk-taking is limited, and they need to deposit a certain amount of money for impending financial demands (e. g., marriage and buying a house). The investment goal at this stage is to perform an asset accumulation and enrich them with relevant investment knowledge. This group invests in stable-earning and low-risk savings, national debt and income funds, so that they can obtain fixed and stable revenue on the basis of value perseverance.

(2) Savings+insurance+stocks+growth funds.

Their investment proportion is 2 : 1 : 4 : 3. This combination is appropriate for residents older than 26 years of age, with annual incomes of 50,000 Yuan or less, and with a moderate level of education.

Most investors at this stage have established their households, and have a comparatively higher income than when they were younger and a stable lifestyle, so they can afford to take some investment risks.

(3) Savings+insurance+stocks+housing property.

Their investment proportion is 2 : 1 : 4 : 3. This combination is suitable for residents aged 26

Chart 6. The combined model for high income growth

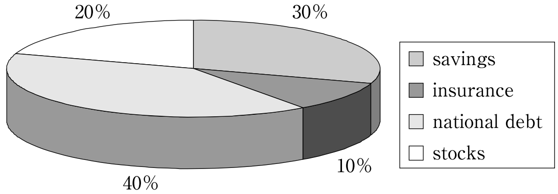
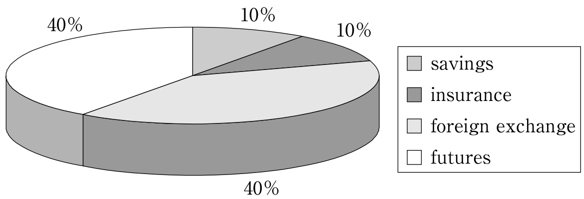


Chart 7. The combined model for high risk and high income



to 45 years, with an annual income of 50,000-100,000 Yuan and a moderate level of education.

The investors at this stage have much stronger investing abilities, as their children have grown up, their undertaking tends to be steady, and they have rich experience. Having learned about the correlation between risk and return, they can afford to take some risk while pursuing higher returns.

(4) Savings+insurance+national debt+stocks.

Their investment proportion is 3:1:4:2. This combination is appropriate for residents over the age of 46 years who have an annual income of 50,000-100,000 Yuan and a moderate level of education.

Investors at this stage have enough time and energy to research and invest in stocks, for their children are now independent. Additionally, due to their long length of work service, they have a certain asset accumulation, and a lower level of financial burden.

(5) Savings+insurance+foreign exchange+futures.

Their investment proportion is 1:1:4:4. This combination is suitable for investors aged 26 to 35 years, who have an annual income of more than 100,000 Yuan and a high level of formal education.

Having solid economic power and being dissatisfied with fixed returns from value-preserving products, the investors in urban China will at this point be more inclined to dabble in such high-risk investment fields as foreign exchange and futures.

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