# Will Shareholding Reform Improve the Performance of Banks in China?

By

**Zhang, Sisi**

A thesis submitted to The Hong Kong Polytechnic University in accordance with the regulations for the Degree of Master of Philosophy

Department of Business Studies
The Hong Kong Polytechnic University
2003

*Abstract of dissertation entitled "Will Shareholding Reform Improve the Performance of Banks in China?"*
*Submitted by Zhang, Sisi*
*for the degree of Master of Philosophy*
*at The Hong Kong Polytechnic University in 2003*

# Abstract

This thesis seeks to analyze and compare the performance of state-owned banks (SOBs) and shareholding banks during the period 1993 to 2000. The analysis and empirical work are undertaken within an institutional framework developed from theories of bank performance.

Despite the fact that the accounting data is incomplete and inconsistent, regression studies tend to support the opinion that ownership is a significant factor in explaining the differential performance between the two groups of banks. It follows that an in-depth institutional analysis originating from the state-owned and shareholding ownership structure of banks can offer more insights into the differential performance.

The relatively worse performance of SOBs can be attributed to the negative impacts of their high stock of non-performing loans (NPLs) inherited from the past, the rigid corporate governance structure, the ineffective enforcement of a credit management system and an inflexible personnel policy. In contrast to SOBs, the comparatively better performance of shareholding banks is due to exemption from policy loans and historical burdens, effective corporate governance, and market-oriented personnel policy and incentive mechanism. Although, shareholding banks possess advantages over SOBs; it is argued that PBOC exercises an unfair supervision - SOBs enjoy preferential treatment in conducting new and profitable business while shareholding banks are prevented from such opportunities. In addition, more policy support is lent to SOBs to solve their NPLs while little effective measures help shareholding banks to do so.

Findings of the thesis support the justification of policy actions taken by the government

and commercial banks in recent years. The government policies include enhancing the supervisory role of the PBOC, setting up of asset management companies and policy banks to prevent the formation and reduction of NPLs in the four SOBs, and improving the financial and governance structure of banks and their credit management. On the other hand, the commercial banks have also taken several remedial measures to improve their management and performance such as reducing costs of employees and branches, setting up a credit scoring system, and improvement of audit and accountability systems.

Based on the research in this study and taking into account the threat of competition from foreign banks after China's entry to the WTO, several recommendations could be made. The government should adopt effective measures to help shareholding banks to write off bad loans, the PBOC should continue the policy efforts of allowing banks to provide a wider scope of non-banking business, and market-based personnel policy and incentive mechanism should be allowed. Both SOBs and shareholding banks should strengthen their capital base and be monitored closely, while actively promoting their consumer products, and seeking partnerships with foreign banks.

# Acknowledgements

Many people assisted me in finishing this thesis. Although it is impossible to cite each person individually, a few deserve special thanks.

First of all, I gratefully acknowledge the financial support and the pleasant office environment provided by the Department of Business Studies, The Hong Kong Polytechnic University, for accomplishing this research in Hong Kong.

I am particularly indebted to my chief supervisor, Dr. John Lee, who has been so generous with his time in improving my thesis. His experience and encouragement have provided an invaluable source of motivation throughout the study. My cordial thanks also go to my co-supervisor, Dr. M.K. Leung, who contributed constant and tremendous efforts on my thesis both through his academic advice and encouragement. Indeed, without the help and encouragement of both supervisors, I would not have been able to complete this thesis.

I would also like to acknowledge my special thanks to my friends, Mr. Xie Jiepeng, Mr. Wang Lei and Mr. Zeng Zhizhao, who either work in banks or study in graduate schools in China, for providing me with first-hand information on banking situations in China and inspiring me to get through the hardest period of writing my thesis.

I also wish to express my heartfelt gratitude to my schoolmates and colleagues, Miss Renne Ng, Dr. Li Wei and Miss Queenie Lam, in the Department of Business Studies, The Hong Kong Polytechnic University. Their genuine friendship has helped me, the only student from the mainland, to adapt to life in Hong Kong.

Finally, my deepest gratitude goes to my parents, whose encouragement and support have helped me immensely.

# CERTIFICATE OF ORIGINALITY

I hereby declare that this thesis is my own work, and that, to the best of my knowledge and belief it reproduces no material previously published or written nor material which has been accepted for any other degree or diploma, except where due acknowledge has been made in the text.

_________________________ (Signed)

Zhang, Sisi _______________ (Name of Student)

# Table of Contents

# List of Tables

# List of Charts

# LIST OF ABBREVIATIONS USED IN THE THESIS

| | |
|---|---|
| ABC | Agricultural Bank of China |
| AMC | Asset Management Company |
| BIS | Bank of International Settlement |
| BOC | Bank of China |
| CCB | China Construction Bank |
| CFPU | China Finance Party Union |
| CIRC | China Insurance Regulation Commission |
| CITIC | China International Trust and Investment Corporation |
| CMBC | China Minsheng Bank Corporation |
| CSRC | China Securities Regulatory Commission |
| HSBC | Hongkong and Shanghai Banking Corporation |
| ICBC | Industrial and Commercial Bank of China |
| MOF | Ministry of Finance |

| | |
|---|---|
| NPL | Non-performing Loan |
| NSE | Non-state-owned Enterprise |
| PBOC | People's Bank of China |
| RCC | Rural Credit Cooperative |
| ROA | Return on Assets |
| ROE | Return on Equity |
| SAFE | State Administration of Foreign Exchange |
| SEZ | Special Economic Zone |
| SME | Small and Medium Enterprises |
| SOB | State-owned Bank |
| SOE | State-owned Enterprise |
| UCC | Urban Credit Cooperative |
| WTO | World Trade Organization |

# Chapter 1 Introduction

## *1.1 Background of the issues*

### 1.1.1 Chinese economic reform and domestic environment

Since the 13th Communist Party of China Central Committee was held in 1978, China's government has been engaging in the comprehensive reform program. On average, China has managed a higher savings and Gross domestic product (GDP) growth rate of approaching 10% per annum during the period from 1988 to 1995 (Lardy, 2000). The high growth rates were more impressive than those from the more developed countries and regions like Germany, Japan, Hong Kong, and South Korea (Wang, 1998). Table 1.1 shows the average GDP growth rate of four countries from 1988 to 1995. From the table, we can judge that China's GDP growth rate, approximately 10%, was much higher than 4% of Germany, 5% of Hong Kong, 2.9% of Japan and 8% of Korea. The particularly high growth rate was attributed to the expansion of non-state sector activities, foreign trade, and foreign direct investment (Leung and Mok, 2000).[1] However, since 1994-1999, the growth rate of GDP has decreased for six consecutive years, from 14.2% in 1992 to 7.5% in 1999 (see Chart 1.1). Some deep structural problems are believed to result in the slow down of economy and one of them is the unhealthy banking system in China (Gong and Dai, 1997).

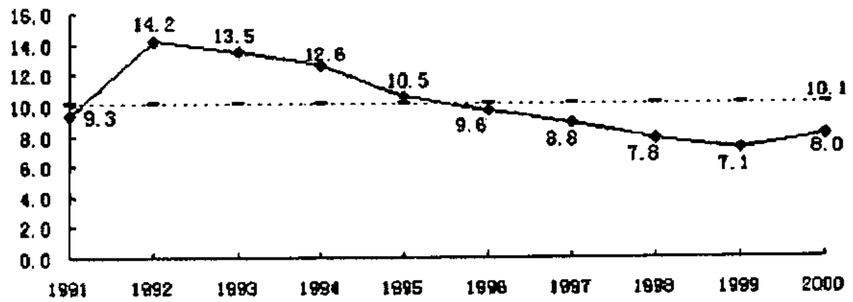
[1] According to China Statistical Yearbook (2000), the annual growth rate of non-state sector activities from 1989 to 1999 was 47.14%; the annual growth rate of foreign trade from 1989 to 1999 was 22.15%; and the annual growth rate of foreign direct investment from 1989 to 1999 was 34.45%.

**Table 1.1 The average annual growth rate of Germany, Japan, Hong Kong and Korea from 1988 to 1995**

| | Germany | Japan | Hong Kong | Korea | China |
|---|---|---|---|---|---|
| Average Annual Growth Rate from 1988 to 1995 | 4% | 2.9% | 5.3% | 8.1% | 10% |

Sources: International Statistical Yearbook, (1996, 1997).

**Chart 1.1 China's GDP growth rate from 1991 to 2000**




Source: Yu, Yong-ding (2001), p.6.

Since 1978, China has embarked on a spate of banking reforms, aiming to support and sustain the growth momentum of the country. The mono-bank system in the pre-reform era was broken up and more banks of diversified ownership were established. There now exists a multi-layered banking structure comprising four wholly state-owned banks (SOBs), shareholding banks, city commercial banks, and urban and rural credit co-operatives. As a result, banks have increasingly taken an active role in the process of financial intermediation[2]. Lardy (2000) argues that from 1987 to 1997, the share that banking system took in the financial intermediation is roughly 90%.

Together with the rapid development of banking industry in China, serious problems such as under-capitalization and high ratio of non-performing loans (NPL) began to characterize the weak financial structure of Chinese banks, which is believed to be linked with the financing system in China.

Since the reform, the corporate finance in China has shifted from the state-budget finance to state bank loan dominated finance and SOBs become the major finance provider of SOEs. The loans extended by SOBs become the major source for state-owned enterprises (SOEs) to finance the working capital and fixed assets. According to a study by Wu (1997), at the end of 1994 the debt to working capital ratio of SOEs has reached 95% while almost all the working capital came from the loans extended by SOBs. The debt to asset ratio of SOEs is also shockingly high. Chen (1999) argues that the debt to asset ratio of SOEs was about 20-25% in 1985, while the figure skyrocketed to an alarming 82% in 1995. Since most funds of SOBs were directed to SOEs, the performance of SOEs played a decisive role in accounting for SOBs' performance. Unfortunately, SOEs' performance and role in

[2] According to China Almanac of Finance and Banking, during the period 1979 to 1999, deposits and loans have registered a yearly increase of 31.66% and 21.13% respectively.

national economies were deteriorating these years, which undermines asset quality of SOBs and causes the formation of huge volume of NPLs.[3] China's top financial official said that by September 2001, NPLs totaled 1.8 trillion RMB (about 220 billion U.S. dollars), equal to 26.62 percent of the four SOBs' total loans. What's more, about 476 billion RMB in loans has been lost.[4] In 1998, the Moody's Investors Service gave SOBs rating E in respect of financial strength, except that Bank of China got E+ (Anonymous, 1995). Compared with other banks in the world, the SOBs are almost the least profitable banks (Wang, 1998). For example, according to statistics from The Banker (2001), the four SOBs only managed 0.01% to 0.34% return on assets (ROA) by the end of 2000 while banks in Hong Kong such as Standard Chartered and Hongkong and Shanghai Banking Corporation (HSBC) managed ROA of 1.3% to 1.4%, a much higher figure than that of SOBs.

As the economy becomes more and more market-oriented, the banking system's inadequacies have become increasingly acute. The inability of banking system to allocate the country's capital efficiently is arguably one of the most serious problems of the country's infrastructure (Anonymous, 1996). As a result, the importance of Chinese banking reform not only exhibits in banking reform itself, but also in the

3 SOEs' problem remained a stumbling block to further economy reform in other economic sector, for Wei (1999) points out that SOEs are making huge loss and the role of SOEs in economy is declining. About half of industrial SOEs made loss in 1996, up from one-third in 1994 (Cooper and Zheng, 1998). He (1998) further argues that the loss of SOEs reached to 69 billions RMB in 1996, eight times of the figure in 1988. The declining role of SOEs embodies in the fact that the ratio of SOEs' output to national total output has fallen from 77.6% in the onset of reform to 29% in 1998 (Dong, 1999).

4 People's Daily, 01 November 2001.

reform of SOE, and even the social stability.

**1.1.2 Changes in the external environment**

The 1997 financial crisis has underpinned the importance of the soundness of the financial system. Weak financial system such as that of Japan prevents an effective defense of the exchange rate and add to the fireworks of the collapse and depth and duration of the post-crisis distress" (Dornbusch and Giavazzi, 1999). While the sound financial system such as the one in Hong Kong has proved to be a protective wall from financial crisis and led the region to survive the crisis more successfully. Though China's banking system proved immune from the banking crisis when many countries in Asia could not escape the disaster, it is pointed out that if measured by the proportion of bad loans to good ones, China's banking system may be the worst one in Asia (Anonymous, 1998). It is due to high saving rate, and few alternative saving vehicles, China's banking distress remains a quiet distress (Dornbusch and Giavazzi, 1999). Therefore, it is wise to take action before the crisis breaks out and Japan's case fully validates that banking reform should be implemented before a crisis hit. Post-crisis reforms are much more difficult and may not always work (Laurence, 1999).

China's entry to the World Trade Organization (WTO) also has important implications for the banking reforms in China. On December 11, 2001, after 15 years' negotiation China entered WTO, becoming the 143rd member of this organization. According to China's WTO commitment, China will phase out restrictions on foreign banks and adhere to its commitments to open the banking sector and further deepen financial reform. China promises to: 1) Gradually abolish limitation on foreign-invested banks to give them free market access; 2) Gradually increase number of representative office of foreign security facilities and permit foreigners to establish fund management corporations; 3) Gradually cancel all regional limitation of insurance industry to enlarge business scope of foreign insurance companies in China. Table 1.2 lists the steps that Chinese government will take to open its banking industry. From the table, we can tell, within 5 years, the competition between domestic banks and foreign banks will be more dramatic as banking industry open more.

**Table 1.2 The steps to open banking industry within 5 years**

| Time | Measures to take |
|---|---|
| **At the time of accession of WTO** | 1. Geographical restrictions on foreign bank's foreign exchange business will be removed gradually. The cities open for RMB business: Shenzhen, Shanghai, Dalian, and Tianjin.<br>2. Allow foreign banks to conduct foreign exchange business with Chinese enterprises and households. |
| **One year later** | The cities open for RMB business: Guangzhou, Zhuhai, Qingdao, Nanjing and Wuhan. |
| **Two years later** | 1 The cities open for RMB business: Jinan, Fuzhou, Chengdu, and Chongqing.<br>2. Foreign banks will be allowed to do local currency business with Chinese enterprises. |
| **Three years later** | The cities open for RMB business: Kunming, Beijing, and Xiamen. |
| **Four years later** | The cities open for RMB business: Shantou, Ningbo, Shenyang, and Xian. |
| **Five years later** | 1. No geographical limitation on RMB business for foreign banks.<br>2. Foreign banks will be allowed to do local currency business with all Chinese customers.<br>3. All the non-prudential restrictions on ownership, operational and organizational setup, including restrictions on number of branches and licenses will be removed.<br>4. Foreign non-bank financial institutions will be allowed to provide auto consumer credit. Foreign funded financial leasing companies will be able to provide financial leasing services. |

Source: PBOC website www.pbc.gov.cn

Actually, China first opened financial market in 1979 and the restrictions exerted on foreign banks have been gradually lifted. In 1997, Shenzhen after Shanghai became the second location that foreign banks can operate RMB business. In March 1999, the locations for foreign bank operational establishment expanded to all major cities across the country. According to PBOC, at the end of September 2001, there were 190 foreign operational financial institutions including 158 branches and 9 sub-branches. The total assets of foreign banks amounted to US$44 billion. Their loans totaled US$18.6 billion and deposits US$6.5 billion.[5] Though the assets of foreign banks only took up 2% in banking assets in China, the foreign currency loans extended by foreign banks has reached a market share of 20% and it even reached 50% in coastal regions. Compared with Chinese banks, foreign banks have some advantages that will bring Chinese banks challenges. First, the capital bases of these banks are much stronger than those of Chinese banks. Take Shanghai for example, 70% of the foreign banks in Shanghai ranked Top 50 in world with regards to "one-tier" capital. While only two Chinese banks -- Bank of China (BOC) and Industrial and Commercial Bank of China (ICBC) -- ranked top 50 with regards to "one-tier" capital (Wu, 1998). Secondly, foreign banks exempted from the policy loans have healthy financial condition and market-oriented operational goals. Sharply contrast to the low NPL ratio in US banks (estimated to be 0.67%), the figure in China is shockingly high (Jiao, 1999). It is reported that the ratio ranges from 20% to 25%. Thirdly, foreign banks possess advanced management skills and

[5] PBOC website: www.pbc.gov.cn

established relationship with multinational enterprises. With this advantage, foreign banks can easily occupy market for international settlement, which is attractive for the low risk, low cost, and high profits. It is estimated that 40% of the market share for international settlement has been taken up by foreign banks by the end of 1999 (Jiao, 2000). In addition, foreign banks are adept at applying technology to banking products, while Chinese banks just start to explore this field (Guan and Wang, 1998).

Therefore, WTO will inevitably bring challenges for Chinese banks, including competition for good customers, talents and market share. Only by deepening domestic bank reform and coping with various challenges, Chinese banks will be able to strengthen their competitiveness.

## *1.2 Objectives*

In addition to the four SOBs, 10 shareholding banks have been set up,6 based on the system of shareholding structure. The establishments of ten shareholding banks not only attempt to make banking system more diverse (Pei, 1998), introduce competition and broaden the channels of financial intermediation (Leung and Mok, 2000), but also to explore the direction of reform for four SOBs – how to improve the corporate governance of SOBs and the performance of four SOBs. Therefore, it

[6] The ten shareholding banks are Bank of Communications, Shenzhen Development Bank, China Merchants Bank, China Everbright Bank, CITIC Industrial Bank, Minsheng Bank, Huaxia Bank, Shanghai Pudong Development Bank, Guangdong Development Bank and Fujian Industrial Bank.

will be interesting to study how the two groups of banks – four SOBs and ten shareholding banks – have performed given internal demand and external changes. Also it is worthwhile to bring up some policy and managerial implications for Chinese banking reform on the basis of the study.

To sum up, the objectives of the thesis are as follows:

1) To examine factors underlying the increasingly diversified banking structure in China.

2) To identify and examine factors underlying the differential performance of the two groups of banks.

3) To derive the policy and managerial implications based on the above analyses, especially following China's entry to the WTO.

## *1.3 Methodology*

Both quantitative analysis and qualitative analysis are employed in this study. First, literature on theories of performance of banks especially theories that apply to Chinese specific context is reviewed. Then, based on the literature review, a regression model is developed and secondary data are employed. By conducting regression analysis, some quantitative results are brought up. Finally, in a bid to supplement the quantitative analysis, fieldwork interviews to explore the organizational and managerial issues of the two groups of bank are conducted.

## *1.4 Organization of the thesis*

Guided by this theme, Chapter 2 firstly attempts to review Chinese banking reform including the institutional development of banking system, the development of regulatory framework and problems that lie in banking sector. 2. In Chapter 3, the difference of performance of SOBs and shareholding banks is explored by regression analysis and the external factors influencing banks' performance -- historical factors and policy environment -- are discussed. Based on interview analysis, Chapter 4 is devoted to examining internal factors including corporate governance, personnel management and credit management, which are believed to have impact on differentiating the performance of shareholding banks and that of SOBs. On the basis of Chapter 3 and Chapter 4, Chapter 5 brings out policy implications and recommendations for Chinese banking system. In Chapter 6, a conclusion of the thesis is given.

# Chapter 2 Banking reforms in China: institutional development, problems and challenges

## *2.1. Introduction*

Though China proved to have severe problems in its banking system, Nagashima (1999) concludes that China has important advantages compared with other countries with similar problems in banking system. There is a clear and strong political will to solve the problem and China's social and political system can ensure that this political will is realized. Then what measures has China taken to reform banking system in the past 20 years? This chapter will start reviewing the institutional development of banking system from 1979 and point out problems and challenges that lie in the banking system.

## *2.2 Banking system before reform: Mono-Bank system*

A mono-bank system based on the Soviet model monopolized the Chinese financial system for nearly 30 years. "The system primarily managed the deposits of SOEs, and secondarily took deposits from customers who were unable to spend the whole of their meager incomes on desired goods, channeling these funds towards investments in state production of heavy industry according to the dictates of the authority" Cargill and Parker (2001). Under the "Da yi tong" system,[7] all banks

[7] "Da yi tong" system is a Chinese term. It means that only one bank - PBOC whose scale was large that dominated the financial system.

were either controlled by or merged into PBOC. PBOC played the role of both central and commercial banking. Conventional commercial loans were regarded as a taboo against planned economy. All domestic credit transactions were handled through PBOC. PBOC did not need to evaluate creditworthiness of SOEs or their investment projects and it only needed to extend loans to match for state's intentions. Credit plans assigned credit quotas to each bank. Leung and Mok (2000) argue that banks acted as an administrative hierarchy to help treasury ensure the fulfillment the whole economy targets.

Besides the underdevelopment of banking system, the stocks and bonds were deemed as something related to capitalism and as a taboo. To express the economic strength, China once proudly proclaimed that it was the only country in the world that had neither foreign nor domestic debt.

## *2.3 The growing diversified banking structure since reform took place*

### 2.3.1 The establishment of four SOBs

Stimulated by the meeting of the 13th Communist Party of China Central Committee held in late 1978, China's economy began to transform from the highly centralized planned economy to socialist market one. Guided by Deng Xiaping's thoughts, "we should reform our banks into real banks", China's banking reform has taken place since then. The mono-bank system proved unsustainable and since 1979, the Agricultural Bank of China (ABC), China Construction Bank (CCB) and BOC were separated from the operations of the PBOC and became independent banks. These banks respectively replaced the PBOC to provide service to the rural areas (ABC), industry fields (CCB) and foreign trade and exchange business (BOC). In September 1983, the state council formally named the PBOC as a central bank. As a consequence, a new specialist bank, the Industrial and Commercial Bank of China (ICBC) was established in 1984 to take over the majority of banking offices and operations of the PBOC in major cities. Since then, PBOC formally functioned as central bank, and the central banking system was established in 1984. At the same time, China International Trust and Investment Corporation (CITIC) was set up to manage foreign borrowing.

The newly established or reinstated banks, which were hoped to operate more efficiently, were rigidly restricted to the specific business scope, clients (Ma, 1996) and non-price competition (Tang, 1999). The reform in this stage achieved to break the mono-bank system by rehabilitating 3 specialized banks and establishing a new one. However, the four banks were still strictly controlled by PBOC.

### 2.3.2 The expansion and institutional development of banking system

Since the mid 1980s, many shareholding institutions and non-bank financial institutions such as investment and trust companies, leasing companies, and finance companies of diversified ownership have been added to major coastal cities, special economic zones (SEZs), along with the proliferation of collectively-owned credit co-operatives in cities and rural areas. These shareholding banks are based on Shanghai (such as Bank of Communications (1986)), Shenzhen (such as Shenzhen Development Bank (1987)), Guangzhou (such as Guangdong Development Bank (1988)), Beijing (such as CITIC Industrial Bank (1987)), Fuzhou (such as Fujian Industrial Bank (1988)). Though they were established as a shareholding entity, these banks were either owned by state-owned conglomerates or by local governments. The establishment of Minsheng Bank in 1996 was hailed a breakthrough in terms of ownership since it was claimed as the first non-state-owned bank.

Besides the proliferation of shareholding banks, especially noteworthy was the emergence of large number of non-bank financial institutions, which include rural and urban credit cooperatives, trust and investment companies, finance firms, leasing firms, insurance companies, and securities firms. These non-bank financial institutions mostly sprang up in 1980s. At the end of 1999, there were 90 city commercial banks, 836 urban credit cooperatives (UCCs), and 41,755 rural credit cooperatives (RCCs) countrywide.[8] The assets of these institutions totaled RMB 2.104 trillion, representing 15.8% of the total assets of all depository institutions. These small and medium financial institutions have been playing an important role in supporting the development of small and medium business and the expansion of employment which Park and Sehrt (2000) believe are excluded by the formal banking system.

[8] Almanac of China's Finance and Banking (2000).

In 1993, China announced a further acceleration in its financial sector reforms under the auspices of its new "Socialist Market Economy" policy (Parker, 1995). SOBs were further commercialized, and each was responsible for its own bottom line. In 1994, to separate commercial business and policy business in SOBs three policy banks were established to take over the policy lending made by the existing SOBs, which can then focus their commercial lending. The three policy banks are the State Development Bank of China, the Export-Import Bank of China, and the Agricultural Development Bank of China. Table 2.1 presents the main business area of each policy bank. It was perceived as a key step toward the commercialization of banks, the idea was proposed in 14$^{th}$ communist Party of China central committee.

In 1985, the entry of foreign banks was deemed as an "open door policy" in financial markets and a quick way of increasing the quality of banking (Leung and Mok, 2000). Since then, foreign banks have been allowed to set up branches in SEZs and other selected cities.

**Table 2.1 Main mandates of the three policy banks**

| **Bank** | **Main mandate** |
|---|---|
| **State Development Bank of China** | Foster the construction of infrastructure, basic industries and pillar industries through financing. Support the nation regional development policy. On-lend loan from the international financial institutions. |
| **Export-Import Bank of China** | To carry out the state industrial policy, foreign trade policy and financial policy, to promote the export of Chinese mechanical and electronic products, complete sets of equipment and high and new-tech products, and to enhance overseas economic and technological cooperation and exchanges by means of policy financial support. |
| **Agricultural Development Bank of China** | To carry out the state agricultural policy and financial policy, to be agent for the funds of supporting agriculture, to enhance agricultural economies by means of policy financial support. |

Source:
China Development Bank website: http://www.cdb.com.cn/index.html
The Export-Import Bank of China website: http://www.chinaexim.gov.cn/
PBOC website: http://www.pbc.gov.cn

## *2.4 The development of regulatory framework*

### 2.4.1 The PBOC's role and its function

The PBOC is the central bank of China. Located in Beijing, the PBOC maintains two operations offices, nine regional branches, 326 prefecture-level sub-branches and 1827 country-level sub-branches. It was established on December 1, 1948 based on the consolidation of the former Huabei Bank, the Beihai Bank and the Xibei Peasant Bank. The State Council decided to have the PBOC function as a central bank. The Law of the People's Republic of China on the People's Bank of China passed on March 18, 1995 legally confirmed the PBOC's central bank status.[9]

Currently, PBOC's main functions include:

a) Formulating and implementing monetary policy;

b) Issuing and administering the circulation of the currency;

c) Licensing and supervising financial institutions;

d) Regulating financial markets;

e) Managing official foreign exchange and gold reserves;

f) Acting as fiscal agent; maintaining payment and settlement system;

g) Collecting and analyzing financial statistical data;

h) Participating in international financial activities at the capacity of the central bank;

i) Overseeing the State Administration of Foreign Exchange (SAFE).

[9] PBOC website: www.pbc.gov.cn

To sum up, the chief mandate of PBOC is to formulate and implement monetary policy and supervise and regulate the financial industry. In respect of financial supervision, PBOC assumes the responsibilities including: to approve, supervise and administer financial institutions and financial market, to promulgate ordinances and rules concerning financial administration and business, to maintain the legitimate stable and sound operation of the financial industry.

The head office of the PBOC consists of 13 functional departments. In order to ensure scientific formulation and implementation of monetary policy and effective supervision of financial institutions, the functional departments are complemented by five supporting departments, namely, the Research Bureau, the Bureau of Currency, Gold and Silver Administration, the Bureau of State Treasury, the Security Office, and the training center. Among the 13 departments, four departments – Banking Supervision Department I, Banking Supervision II, Department of Non-bank Financial Institutions and Department of Cooperative Finance -- fulfill the supervision function. Table 2.2 explains function of each supervision department.

In 1998, operations and supervision of the finance industry were separated when the central bank relinquished supervision of the securities and insurance markets. There were now three regulatory bodies for the financial services industry: the PBOC, China Insurance Regulation Commission (CIRC) and China Securities Regulatory

Commission (CSRC). All of the authorities are under the State Council. The financial services market is also governed by the various regulations issued by the Ministry of Finance (MOF). CIRC assumes the responsibility of supervising insurance industry and formulating policies and regulations related to insurance market. CSRC establishes a centralized supervisory system for securities and futures markets and assumes direct leadership over securities and futures market supervisory bodies. In addition, it organizes the drafting of laws and regulations for securities markets.

**Table 2.2 Functions of the four supervisory departments in PBOC**

| Department | Major functions |
|---|---|
| **Banking Supervision Department I** | Supervises four SOBs, policy banks, asset management companies, foreign banks, and postal depository institutions. |
| **Banking Supervision Department II** | Supervises shareholding banks, city commercial banks, housing depository banks and urban credit cooperatives (district level above). |
| **Department of Non-Bank Financial Institutions** | Supervises trust and investment companies, finance firms, leasing firms and foreign non-bank financial institutions. Cooperates with security and insurance supervision authorities. |
| **Department of Cooperative Finance** | Supervises rural credit cooperatives and urban credit cooperatives (county level below). |

Source:
PBOC website: www.pbc.gov.cn

### 2.4.2 The legal framework

In 1995, a series of historically important laws have been passed to improve China's financial landscape. The successive passing of the Central Banking Law, Commercial Banking Law, Negotiable Instruments Law, and Guarantee Law indicates the beginning serious reforms to China's legal framework.

The Law of The People's Republic of China on The People's Bank of China is China's first central bank law and was passed on 18 March 1995. It sets the PBOC's status, responsibilities, organizational structure, functions and monetary policy targets. It also gives the PBOC the authority to supervise the country's financial services industry. This law provides the framework for formulating and implementing monetary policy, for establishing and improving the PBOC's macro-control structure, and for enforcing supervision of the financial industry. However, the PBOC Law is unsuccessful to bring PBOC independence from government: the newly created Monetary Policy Committee is rather an administrative role with members designated by government.

The Commercial Banking Law was passed on 10 May 1995 to protect the legal interests of commercial banks, depositors and other bank customers. It also standardizes the operations of commercial banks, regulates the quality of their assets, ensures sound operations, and promotes the development of China's socialist market economy. According to the law, the head offices of the 4 specialized banks are responsible for their own financial condition. All the banks should strictly abide by the requirement of ratio set by the law. Especially the law requires that the capital adequacy ratio of each bank should not be below 8%.

Based on the two above laws, the central bank's supervision is exerted through:

a) The central bank reviewing and approving the establishment and business scope of financial institutions as well as changes to them and their termination.

b) Commercial banks filing their balance sheets, profit and loss accounts, and other financial statements and information with the central bank regularly.

c) The central bank conducting on-site examinations of commercial banks in areas of deposit, loan, settlement and non-performing assets, among others, and

d) Commercial banks being subject to the audit of auditing authorities.

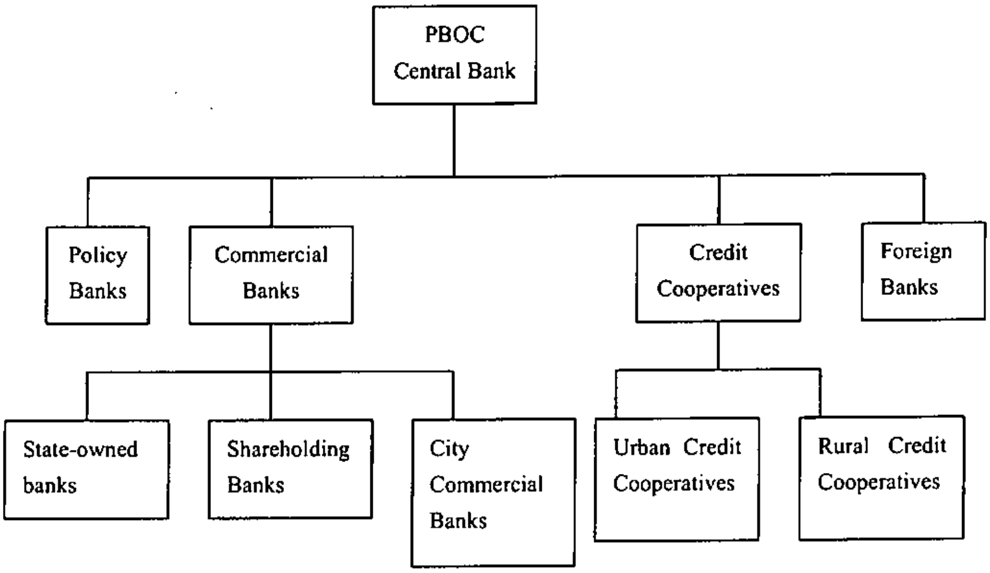
## *2.5 The current banking system in China and the dominant role of banking system and SOBs*

After 20 years' banking reform, a banking system characterized by a multiplayer and multi-category structure has taken into shape in China. PBOC has been turned step-by-step into a genuine central bank; policy banks have been established to take up the job of policy lending; the SOBs are being transformed into commercial banks. Meanwhile shareholding banks, city commercial banks[10], urban and rural credit cooperatives and foreign banks were introduced to increase the competition of

10 City commercial banks were set up in the mid 1990s when the central government allowed local government to establish local banks by consolidating local urban cooperatives. Their business scope is restricted to their own localities.

banking system. Chart 2.1 exhibits the current structure of banking system in China.

**Chart 2.1 China's Banking System**




Like Japan and Korea, China has a financial system, which government views it as an instrument of industrial policy designed to transfer the majority of funds from surplus to deficit units through intermediation markets, especially bank finance. By the mid-1990s, despite the rapid development of stock market, banks still accounted for 90 percent of China's financial intermediation, much more than in other Asian economies (Lardy, 1998). Table 2.3 lists the data of China's stock market capitalization and the percentage in GDP from 1992 to 2000. Though the percentage of stock market capitalization over GDP has increased from 3.93% in 1992 to 53.79% in 2000, and the market capitalization of tradable shares over GDP has increased from 2.06% in 1994 to 10.03% in 2000, the figures are meager compared to that of banking system. Lardy (2001) argues that the four SOBs had assets of more than RMB 10,000 bn ($1,200 bn) at the end of 2000, already equivalent to 115% of China's GDP.

**Table 2.3 Stock Market and National Economics (RMB 100 MM)**

| Year | GDP | Market Capitalization | | Market Capitalization of Tradable Shares | |
|---|---|---|---|---|---|
| | | Amount | Over GDP | Amount | Over GDP |
| 1992 | 26,638 | 1,048 | 3.93 | NA | NA |
| 1993 | 34,634 | 3,531 | 10.20 | NA | NA |
| 1994 | 46,759 | 3,691 | 7.89 | 965 | 2.06 |
| 1995 | 58,478 | 3,474 | 5.94 | 938 | 1.60 |
| 1996 | 67,885 | 9,842 | 14.50 | 2,867 | 4.22 |
| 1997 | 74,772 | 17,529 | 23.44 | 5,204 | 6.96 |
| 1998 | 79,748 | 19,506 | 24.46 | 5,745 | 7.20 |
| 1999 | 81,911 | 26,471 | 32.32 | 8,214 | 10.03 |
| 2000 | 89,404 | 48,090 | 53.79 | 16,087 | 17.99 |

Source:
CSRC website: www.csrc.gov.cn
National Bureau of Statistics of China website: www.stats.gov.cn

From the perspective of listed companies, the role of capital market is weak too. By the end of November 2001, there were only 1153 listed companies and only 7.722

billion RMB was raised through stock market.[11] While, according to PBOC, by the end of October 2001, the loans extended by banks have reached 10.899 trillion RMB.[12] In conclusion, banks still dominate financial industry in China.

While the banks dominate the financial industry, SOBs dominate the banking system. Table 2.4 presents the percentage of each group took in assets, capital, loans and deposits in 1999. From the table, four SOBs took percentage of 73.8%, 80.9%, 75.8% and 69.5%o in assets, capital, loans and deposits respectively. The absolute advantage concludes that the four SOBs monopoly banking system. While UCCs take the least share in banking market.

**Table 2.4 The percentage of each group of banks in assets in 1999 (In %)**

| Bank Group | Assets | Capital | Loans | Deposits |
|---|---|---|---|---|
| SOBs | 73.8 | 80.9 | 75.8 | 69.5 |
| Shareholding Banks | 12 | 7.1 | 8.6 | 8.9 |
| UCCs | 5.3 | 3.3 | 5 | 6.6 |
| RCCs | 8.9 | 8.7 | 10.6 | 15 |

Source: Almanac of China's Finance and Banking (2000)

[11] CSRC website: www.csrc.gov.cn

[12] PBOC website: www.pbc.gov.cn

## *2.6 The weaknesses of the banking system*

The huge number of branches and employees impose high costs on the SOBs, which is one of the major weaknesses of the Chinese banking system. Table 2.5 exhibits the figure of branches and profits per employee in the four SOBs, shareholding banks, HSBC and Citibank. From the table, we can find the number of branches of all the shareholding banks is just 4,407 and HSBC with 4,602 billion assets, one of the largest financial services group in the world has only 6,500 offices. While the figure for all the four SOBs is 135,704, thirty times that of shareholding banks. Actually, ABC has the largest number of branches, the figure reached 56,539 in 1999 and the figure is eight times of that HSBC. When it comes to number of employees, except BOC with relatively smaller number of employees, each SOB has 324,360 to 539,298 employees, the figure is quite titanic compared with the figure of HSBC and Citigroup which have just one third to half the number while their assets are more than any of the SOBs. The huge number of branches and employees did not bring huge profits for SOBs. In terms of profits per employee, the figures of Citigroup and HSBC are 20 to 30 times those of SOBs and 6-7 times that of shareholding banks! Therefore, the Chinese banking system with a large number of branches and employees bears high cost, which precludes it from competing with foreign banks efficiently.

**Table 2.5 The number of branches and employees, and profits per employee in SOBs and shareholding banks (1999) compared with HSBC and Citibank**

| Banks | Assets | Number of Branches | Number of Employees | Profits per employee |
|---|---|---|---|---|
| SOBs | 10,634.856 bn | 135,704 | 1,701,370 | N.A. |
| ICBC | 3,539.866 bn | 36,908 | 540,178 | 15,117 Yuan |
| BOC | 2,618.09 bn | 14,368 | 197,534 | 14,730 Yuan |
| ABC | 2,275.835 bn | 56,539 | 539,298 | N.A. |
| CCB | 2,201.065 bn | 27,889 | 324,360 | 15,290 Yuan |
| Shareholding Banks | 1,409.045 bn | 4,407 | 96,485 | 63,460 Yuan |
| HSBC | 4602.2160 bn | 6,500 | 145,847 | 450,420 Yuan |
| Citigroup | 6547.6563 bn | N.A. | 212,500 | 382,500 Yuan |

Source: Almanac of China's Finance and Banking (2000)
HSBC website: www.hsbc.com
Citigroup website: www.citigroup.com

The second weakness of the Chinese banking system is the high stock of NPLs. According to Cargill and Parker (2001), "China's major commercial banks are essentially insolvent, with 22 percent of loans reported as non-performing in 1995, an amount over four times their net worth but still likely understated". Lardy (2001) further points out that if the new criteria had been applied[13], NPL in 1999 would

13 China had a unique classification system that NPLs were categorized into 'overdue', 'doubtful' and 'bad' based on the duration of the loan that default. The new method based on risk was introduced in 1999, which is illustrated in chapter 5 (p.114).

have accounted for 39 percent of the bank's loan portfolio – 2.6 times more the figure when the old criteria was used. The flow problem of NPLs is severe as well. Though Chinese government has putting increasing pressure on banks to reduce bad loans and to exercise more caution in future lending, it is reported that in late 1990s, the unrecoverable debt problems continue to worsen, rising by approximately 2 percent per year. "An additional RMB 400 billion emerged in new bad loans during 2000, equivalent to more than 4 percent of GDP" (Lardy, 2001). By 2000, the SOBs have claimed 5,000bn bad loans, 40-75% of that year's GDP. Lardy (1998) stresses that the rapid escalation of bank credit in China, together with the significant rise in the share of non-performing loans, will likely make China's current rapid growth rates unsustainable.

The NPL problem inevitably results in undercapitalized structure of Chinese banks. It is reported that the capital adequacy ratios of four SOBs fell from 13.2% in 1985 to 2.8% in 1997. Table 2.6 shows capital ratios of four SOBs in 1996. From the table, the four SOBs' capital ratios were considerably weak – except the capital ratio of BOC, those of three other SOBs were as low as 2.1% to 2.9% in 1996. The mainland China average of capital ratio is 3.3% which is meager compared with Hong Kong average --10.9% and lower than 8% required by the Bank of International Settlement (BIS) and the Commercial Banking Law. Since capital ratio represents a bank's capacity to cope with financial risks, and determines its strength and solvency, the poor capital ratio discloses that the banks were technically insolvent.

**Table 2.6 Capital ratios in 1996 (%)**

| | Equity/ Assets | Equity/ Loans | Leverage (times) |
|---|---|---|---|
| **ABC** | 2.9 | 4.7 | 33.8 |
| **BOC** | 4.9 | 9.4 | 19.2 |
| **CCB** | 2.1 | 4.6 | 45.7 |
| **ICBC** | 2.6 | 5.3 | 37.6 |
| **Mainland China average** | 3.3 | 6.4 | 29.6 |
| **Hong Kong average (for comparison)** | 10.9 | 22.0 | 8.2 |

Source: Anonymous, (1998). "China: Recapitalizing the Big Four banks."

The last but not the least problem with Chinese banking system is the interest rate control in Chinese banking system. Wang (2001) argues that Chinese government has always pursued the "financial repression" policy of controlling interest rates and has remained strict control over the deposit and loan interest rate of the domestic currency, which is used to promote financial progress and economic development. In 1990s, the PBOC has conducted 14 adjustments of deposits and loan interests rates. But only after 1996, government began to accelerate the market-oriented reform of interest rates. Table 2.7 lists the major measures that have been adopted to reform the interest rate system.

As we may see from the above table, government has gradually lifted control on interest rates, however discount rates, domestic currency deposit and loan interest are still under the tight control of the central bank. Wang (2001) argues that by tight control of interest rate, the Chinese government has kept the interest rates on deposits and loans below the level under perfect competition. Correspondingly, on one hand, such policy led to the monopolistic position of SOBs because it lowered the cost of SOBs in absorbing deposits and has encouraged SOBs to actively absorb deposits by increasing branches and employees; on the other hand, such policy has deprived SOEs of their due sense of competition and incentives for competition because the cost of financing is greatly lowered.

**Table 2.7 Major measures to reform interest rate system in China**

| Year | Measures |
|---|---|
| **1996** | 1. Established a nationwide unified interbank lending and borrowing market.<br>2. Lifted control over interbank offered rates in June and realize the market transition of interest rates on the primary and the secondary treasury bond markets. |
| **1997** | An interbank bond market was established. Realize the market transition of interest rates of interbank dealing in treasury bonds. |
| **1998** | The central bank enlarged the commercial banks – floating range of interest rates on loans to medium-sized and small enterprises. |
| **1999** | 1. The central bank after 1998 enlarged the commercial banks – floating range of interest rates on loans to medium-sized and small enterprises again.<br>2. The central bank lifted control over the interest rates on RMB borrowings from foreign-capital banks.<br>3. The central bank lifted the control over interest rates on deposits with a lump sum of over 30 million yuan with maturity terms of at least five years by insurance companies.<br>Relaxed the control over interest rates on stock-hypothecated financing. |
| **2000** | Government opened its foreign current deposit and lending market, realizing the market transition of interest rates on foreign currency deposits and lending. |

Source: Wang, Guo-song, (2001).

## *2.7 Conclusion*

In sum, after over 20 years' banking reform, the Chinese banking industry has evolved from a mono-bank system into a diversified one, which includes PBOC as a central bank, and SOBs, shareholding banks, policy banks, credit cooperatives etc as market players. The banking reform not only succeeded in introducing competition, but also succeeded in establishing the legal framework. However, there are still some problems existing in the current banking system: 1) The high operation cost of SOBs resulted from redundant branches and employees. 2) Huge volume of NPLs, which jeopardizes the financial health of banking system. 3) The interest rate control due to "financial repression" policy that China has been pursuing, which is not good to the competition between SOBs and other types of banks.

# Chapter 3 Differential performances of SOBs and shareholding banks

## *3.1 Introduction*

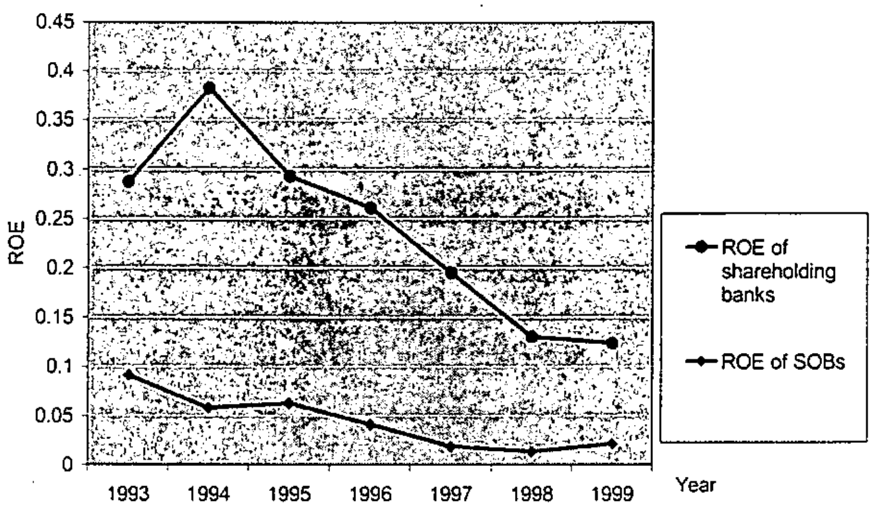
In this chapter, firstly the comparison of performance between SOBs and shareholding banks from 1993 to 1999 is shown and some explanations are offered. Secondly, the literature on theories and their empirical support that depicts the determining factors to the performance of banks will be reviewed. Thirdly, in the specific context in China, the limitation of factors is discussed. Then regression model used in the study and data source are described and summarized. The results of the analysis are then presented. Finally, the need for examining the corporate governance, personnel management, and credit management of the two types of banks is explained.

## *3.2 Comparison of Banks' performance from 1993 to 1999*

Chart 3.1 compares the return on equity (ROE) between SOBs and shareholding banks from 1993-1999. We use the average of ROE of four SOBs and nine shareholding banks in each year for comparison. The circular line stands for the trend of performance of shareholding banks in terms of ROE, while the diamond line stands for that of SOBs. From Chart 3.1, it can be seen that the average performance of the shareholding banks is much better than that of SOBs from 1993 to 1999. The ROE of shareholding banks ranges from 0.13 to 0.39 during this period, while the ROE of

SOBs ranges from 0.03 to 0.09. Meanwhile, the performance of both types of banks is declining during this period except the performance of shareholding banks improves from 0.3 to nearly 0.4 in terms of ROE from 1993 to 1994. Reasons for the declining performance of banks can be attributed to changes in the macro-economy and government policy in China during the period.

**Chart 3.1 ROE comparison between SOBs and shareholding banks**




**(From 1993 to 1999)**

Source: Almanac of China's Finance and Banking (1994 – 2000).

During 1992 to 1993 period, there were hot speculations in China's real estate market and stock market. Consequently, in order to make huge profits, large portion of funds in banks flew into these two markets through two channels. On one hand, bank over-lent their loans to those enterprises speculating in real estate market and stock market; on the other hand, banks set up some subsidiary investment and trust institutions to invest in those two markets directly. However, the macro economy was actually overheated. To keep the economy cool down and realize the "soft landing", in mid 1993 the central government took several measures including closing trust and investment companies set up by banks, banning funds from banks flowing into real estate industry and stock market. The outflow of banks' funds led to burst of the bubbles in these two markets and resulted in many enterprises went bankruptcies, therefore resulting in a huge amount of NPLs in banks in later years after 1993. Following the slump down of the two markets, the macro economy worsened. The deflation, unemployment, decreased consumption has led to reduced investment in business, accordingly decreased the demand for loans. For banks, they were hesitated to further extend loans, fearing that new NPLs will arise. The greatly reduced profits from interest and narrow business scope had led to declining performance of banks from 1993 to 1999.

However, how we can explain the difference of performance between two types of banks in the same macro-economic environment from 1993 to 1999? Is the difference statistically significant? In the next part, the factors that account for bank performance will be examined and methodology employed will be discussed.

## *3.3 Literature on bank performance*

The most common measures of financial institution performance are measures of profitability (Thygerson, 1995). Profits serve as a cushion against adverse condition such as losses on loans or losses caused by unexpected changes in interest rates. Consequently, creditors and regulators concerned about failure also look to profits to protect their interests. In previous literature findings on the issue of banking performance, like most other industries, the accounting data are used as the means to evaluate the performance of banks. In the bank performance literature, return on equity (ROE) and return on assets (ROA) are most commonly used tools (Rose, 1992; Kim and Kim, 1997). They are intended to measure how efficiently the firm uses its assets and how efficiently the firm manages its operations. ROA is a measure of profit per dollar of assets. It evaluates how efficiently the assets of the bank create profits; while ROE is a measure of how the stockholders fared during the year. It evaluates how efficiently the capital has been used to produce profits. ROE can be decomposed into ROA and the equity multiplier (EM=assets/equity). That is:

ROE=ROA x EM.[14]

As in any enterprise, a bank's profitability is related to its ability to generate business, and to reduce costs and risks in its operations. Many theories have tried to relate

[14] EM is average assets divided by average equity, the reciprocal of the capital-to-asset ratio. It provides gauge of a bank's leverage (1-1/EM=debt-to-asset ratio) or the dollar amount of assets pyramided on the bank's base of equity capital.

various factors to the performance of banks, such as size (Lloyd-Williams, Molyneux and Thornton, 1992; Haslem, 1968; Kim and Kim, 1997) and risk (Martinez and Courington, 1993). In the following part, the theories and their empirical support in literature will be discussed respectively:

*Size measured in assets* A large bank will be able to reap scale and scope of economies in its operations. Given a large number of loan contracts, a bank will be able to reduce the transaction costs in its dealing with customers. These costs include measuring costs of collateral, repackaging costs of loan contracts (Diamond, 1984). Moreover, the bank can also achieve diversification of risks from carrying on different lines of business. It follows that the scope of specialization of the bank is a balance between the economies of specialization and the risk reductions in diversification (Benston and Smith, 1976). The empirical studies also prove the relationship between bank size and bank performance. Samolyk (1994) concluded that the average differences in bank performance might be attributable to difference in bank size, capital etc. A large bank will reap scale economies in its operations. Revell (1991) studies the role of size from the perspective of merger and acquisition and reports significant relationship between bank size and efficiency of banking system. While the size effect maybe different from country to country. Kim and Kim (1997) conduct a comparative study on structure-profit relationship of commercial banks in South Korea and the United States during the period from 1991-1993. They find a significant negative relationship with ROA in Korea while a significant positive relationship in the U.S. Apparently, small banks are more profitable than large banks in Korea, while large banks are more efficient and profitable in the U.S.. Kim and Kim also pointed out that the increasing cases of merger and acquisition during 1990s in U.S has explained this phenomenon. No matter what the relationship between size and performance – negative or positive, all the theories and empirical studies have proved that there is significant relationship between two factors.

*Capital measured in equity capital.* Given the assets, a large capital base also refers to a high capital asset ratio. A larger capital will serve to reduce insolvency cost- the risk that a bank may not have enough capital to offset a sudden decline in the value of its assets (in China, mostly loans) relative to its liabilities due to one or more of other risks: market, credit, foreign exchange, liquidity risks. A large capital will enable a bank to expand its assets. The capital asset ratio has therefore become a vital component of strategic planning for a bank (McCarthy and Handorf, 1981). A higher capital ratio is associated with a lower after-tax return on ROE as the higher ratio tends to reduce the risk on equity and therefore lowers the equilibrium expected return on equity required by shareholders. The capital concerns also come from the regulators. In 2001, the new Basle Capital Accord maintains both the current definition of capital and the minimum requirement of 8% of capital to risk-weighted assets as set up in 1988. Despite these arguments, the empirical studies in the Spanish and US banking system tell a different story. Lloyd, Molyneux and Thornton (1994) conduct an empirical study on market structure and performance in Spanish banking in 1994, choosing capital-to-assets ratio as one of explanatory variables and finds that the capital is proved positive and statistically significant to performance of banks. According to Berger (1995), the data on US banks in the mid-to-late 1980s prove that the capital-to-asset ratio and ROE are positively and statistically significant while the data on early 1990s tell that two ratios are negatively significant. Though inconclusive results remain, there is an agreement that capital-to-asset ratio is statistically significant with banks' performance.

*Liquidity measured in equity capital.* A low liquidity, i.e. high loans to deposits ratio can increase the liquidity risks of a bank (Lloyd, Molyneux and Thornton, 1994). However, a high liquidity means that banks must maintain adequate liquidity to meet deposit withdrawals. Given the risks, a low liquidity is expected to have positive impact on ROE. A number of studies have shown how the liquidity risks taken by banks could account for their performance (Rose, 1992; Lloyd, Molyneux and Thornton, 1994). And in the study of liquidity and relative profitability of US banks for the year 1978-1980, Haslem, Bedingfield and Stagliano (1985) found consistently negative association between them.

## *3.4 Applicability of the theories in the Chinese context*

As the Chinese banking system is experiencing the transition from centrally-planned economy to a market economy, the factors that influence its performance are expected to be different from those banks in market economies. Therefore, the following part is devoted to illustrating the limitations encountered when developing performance factors in Chinese banking system. Also, the specific factors affecting banks' performance in China are discussed.

*Performance.* Since the purpose of our study is to compare the performance between two different organizational forms (wholly state-owned and shareholding entity), it is more appropriate to use ROE as the criteria, which, as mentioned above, reflects how the stockholders have been rewarded during the year. Also, in China, the banks' ability to raise capital is still poor;[15] therefore the increasing rate of assets is much larger than that of capital. Accordingly, the difference in ROA is to small to be compared. Thus, ROE is used in this study.

*Ownership measured by equity held by the state or others.* The four SOBs are 100% owned by the central government, while shareholding banks are controlled by various investors and establish an interdisciplinary mechanism -- the role of board of directors is to make key decisions while the managers deal with decision management (Fama and Jensen, 1983). No empirical studies appear to have attempted to investigate the importance of shareholding entities in explaining the difference of bank performance. This is because in well-developed market economy, few SOBs exist. In contrast to a wholly state-owned bank, a shareholding bank has

[15] There are only 4 listed banks that can raise capital through the stock market, other shareholding banks can only strengthen their capital base by issuing shares to specific investors, while the state-owned banks can only resort to government to raise capital.

to be accountable to its shareholders. With the objective of maximizing the wealth, the shareholders will push the banks to be more efficient in their financial operations. And it follows that shareholding banks should perform better. Therefore, in this study, organizational form is first used as a variable to explain the performance of banks in China.

*Capital to asset ratio.* It is known that China's four SOBs got much lower capital adequacy ratio than 8% (Wang, Li and Yuan, 2000), while the figure is much higher in shareholding banks (They claim to be around 8% to meet the Basle Accord). Therefore, the factor will be considered in our study. Due to the unavailability of data, capital to asset ratio instead of capital adequacy ratio calculated through data from Almanac of China's Finance and Banking is used in this study.

*Assets.* As the literature presents, asset size influences the performance of banks by scope economy and is believed to raise the efficiency of banks.[16] However, in China, the four SOBs were established to replace PBOC to monopolize the banking business and with 10 years' history, their assets without doubt are larger than shareholding banks'. It is reasonable to assume that such a scale achieved by historical factors instead of market mechanism is irrelevant to banks' performance. Therefore, in this study, the factor will not be taken into consideration.

[16] In scope economy, the cost of products will decrease as the scope of economy increase.

*Loan to deposit ratio.* Previous study has taken this ratio to evaluate the risk that a bank bears. The risk refers to liquidity risk. However, in China, the money market is still thinly traded and the interest rate is still controlled by PBOC. With government's reputation and backup also as well as limited channels to invest, people tend to put their money into banks. Therefore, deposit is still the main investment tool in China and banks do not need to worry about the source of deposit funds. When a bank is in danger of bank run, government tends to take measures to save them. Therefore, a bank can have high liquidity risk but still runs well under this context. As a result, the liquidity is not much relevant to banks performance.

## 3.5 The Model

With a view to the specific Chinese context, and the limited availability of the observations, simple regression models are estimated. The regression models can estimate the importance of the independent variables, which is precisely what the study attempts to achieve. The test is first to be run year by year, which means each year for each bank constitutes one observation. Since the time period the study analyzes is 7 years, it is reasonable to assume that the model parameters are fixed over bank and over year. So there are 7 regressions obtained since the span of year is 7 years. We denote as Regression 1.1 for year 1993, Regression 1.2 for year 1994...Regression 1.7 for year 1999. And then, the test is to be run on a pool basis. That is to say all observations are estimated with a regression model, which is denoted as Regression 2.[17]

In China's context, as analyzed above, the first two variables will be employed to explain the performance of banks. They are capital to assets ratio and organizational form while organizational form is what this study is interested in. As to the organizational form, though the literature, which considers organization form as a predictor variable, is absent, there does exist some literature, which compares the performance of banks among different types of corporate control (Pi and Timme, 1993). In Pi and Timme's study, a dummy variable CEO&CHAIR is assigned a value of one or zero. In our study, the dummy variable (organization form) is employed, which assigns a value of zero to banks falling into the group of four state-owned banks, and one otherwise. As to capital to asset ratio, the figures can be obtained by calculating data from Almanac of China's Finance and Banking.

Therefore, the model is illustrated as follows:

**Regression 1.1—Regression 1.7: $Y= a + b_1x_1 + b_2x_2$**

**Regression 2: $Y= a + b_1x_1 + b_2x_2$**

Y denotes performance of banks; a, $b_1$, $b_2$ denote the coefficients of intercept

[17] As interviewed with PBOC in Guangzhou, due to the changes in accounting standards over the years, the cross-sectional studies will better reflect the differential performances of the two years of banks. Hence, the pooling of the data will only serve as an indication of the trend.

(represents the error term which incorporate the remaining part of performance that can't be illustrated by selected two independent variables), capital to assets ratio and organizational form respectively. Table 3.1 summarizes the dependent and independent variables in the regression model:

**Table 3.1 The summary of the dependent and independent variables**

| Dependent Variable | |
|---|---|
| ROE | Return on Equity (%) |
| **Independent Variables** | |
| Organization form (regression 1& 2) | 1:shareholding banks, 0: four state-owned banks |
| Capital to assets ratio (regression1& 2) | Capital to assets in year t |

## *3.6 The sample and data*

### 3.6.1 The sample

There are totally 13 banks selected in this study. They are four SOBs – The ICBC, ABC, BOC and CCB; and nine shareholding banks -- Bank of Communications, CITIC Industrial Bank, China Everbright Bank, Huaxia Bank, Guangdong Development Bank, Shenzhen Development Bank, China Merchants Bank, Fujian Industrial Bank, and Shanghai Pudong Development Bank.

The sample includes all the banks in the Chinese banking system, except for Minsheng Bank, and City Commercial Banks. Minsheng Bank is not chosen for two reasons: first it is claimed to be the first private bank in China, therefore is not suitable to be chosen as a sample. Second, it was founded in 1996, the data are not sufficient for our quantitative analysis which has employed 7 years' data of other banks. While the reasons that urban commercial banks are not chosen arise from the considerations that they were originated from credit cooperatives and are relatively small in size and operations by comparison.

### 3.6.2 The data

The accounting data are used as the means by which to evaluate the performance of banks. The balance sheets and profit and loss statements of banks are necessary for calculating the financial ratios needed. In this regard, the various issues of Almanac of China's Finance and Banking were used as the main data resource. However, the data of Huaxia Bank in 1993-1994 and the data of Pudong Development Bank in 1993-1995 are not available in Almanac of China's Finance and Banking. Therefore, in addition the web page of Huaxia Bank was searched and except the data for capital, all other data were found. For Pudong Development Bank, we have contacted with business analyst Ms. Yang in Research & Development Department of the bank to get all the missing data. The period of study is from 1993-1999, where 1993 was the year when all nine shareholding banks were established.

All in all, there are 91 observations and 4 missing data from Huaxia bank, two are the ratios of equity to asset in 1993 and 1994 respectively, and the other two are ratios of ROE in 1993 and 1994.

### *3.7 Statistical results and implications*

The SAS program is employed to run the regression model. Totally 8 regression models are run. The regression results are shown in the Tables 3.2 and 3.3. Regressions in Table 3.2 exhibit higher explanatory power than regression 2, reflected by higher adjusted R2. The figures in parenthesis represent the p value for each estimate of the explanatory variable and the star means the figure is significant in respective significant level (as described above). The coefficients of organizational form in all regressions are reasonable and the fit looks good. They are all significant at 10% level when regressed on a yearly basis and significant at 1% level when regressed on a pooling basis. The relationship between organizational form and performance is positive, indicating that the shareholding banks perform better than four SOBs do. Capital to assets ratio is statistically insignificant in all regression models at significant level 10%. One possible reason that leads to an insignificant estimation could be that the four SOBs gain governmental support. For example, in 1997 MOF injected capital into four SOBs in order to raise their capital to assets ratio while so far MOF never provide such kind of support to shareholding banks. Also, government tends more to give SOBs profitable loan projects than to shareholding banks. While shareholding banks do not gain as much governmental support as four SOBs do. Therefore, in Chinese context where the market-oriented reform is only conducted for 13 years, many factors that proved to be related to bank performance in market economy may be irrelevant.

In sum, our regression models have provided an indication that shareholding banks have performed better than wholly state-owned banks during 1993 to 1999. Then how does organizational form ----SOBs or shareholding banks influence their performance remains an interest for us.

**Table 3.2 Estimation results for regression models on a yearly basis, data from 1993-1999**

| Regression | Intercept | $b_1$ | $b_2$ | Adj $R^2$ |
|---|---|---|---|---|
| 1993 | 0.111833<br>(0.0578) | -0.523801<br>(1.04659) | 0.158236<br>(0.06942)* | 0.4444 |
| 1994 | 0.431341<br>(0.1867) | -10.4493<br>(0.1941) | 0.674059<br>(0.0780) * | 0.1724 |
| 1995 | 0.166533<br>(0.1599) | -3.184520<br>(0.2126) | 0.258455<br>(0.0482) ** | 0.2032 |
| 1996 | 0.085203<br>(0.1926) | -0.925657<br>(0.4506) | 0.193086<br>(0.0207) ** | 0.3408 |
| 1997 | 0.011624<br>(0.7696) | 0.223294<br>(0.7593) | 0.148638<br>(0.0077) *** | 0.5810 |
| 1998 | 0.023774<br>(0.5285) | -0.221825<br>(0.1332) | 0.125881<br>(0.0168) ** | 0.3767 |
| 1999 | -0.029964<br>(0.6430) | 0.959813<br>(0.4028) | 0.02574<br>(0.0143)** | 0.4274 |

Notes: 1. p values are in parentheses.

2. *: Significant at 10% level of confidence, ** significant at 5% level of confidence and *** significant at 1% level of confidence.

3. $b_1$ denotes the coefficient of capital to assets ratio and $b_2$ denotes the coefficient of

ownership.

**Table 3.3 Effects of ownership on banks' performance on a pool basis**
**Dependent variable: Return on Equity (ROE)**

| Regression | Constant term | $b_1$ | $b_2$ | Adjusted $R^2$ |
|---|---|---|---|---|
| 2 | 0.001798 | -0.0000 | 0.013287 | |
| | (0.4588) | (0.46) | (0.0001)*** | 0.1831 |

Notes: 1. p values are in parentheses.

2. ***: significant at 1% level of confidence.

3. $b_1$ denotes the coefficient of capital to assets ratio and $b_2$ denotes the coefficient of ownership.

## *3.8 External environment plays a role in explaining performance difference between SOBs and shareholding banks*

Zhou (2000) and Yi (1999) point out that the historical role and policy environment are two factors that account for the difference in performance of the two types of banks. Shareholding banks are not burdened with a high stock of non-performing loans as the SOBs. Since they were established, they have been exempted from policy roles to extend loans to SOEs and operate as a commercial organ. Therefore, they do not have stock of non-performing loans. The NPLs have put two types of banks on the different level of playing ground and might influence their corresponding performance. Policy environment is a factor as well. Current policy environment for banking industry in China is deemed to treat two groups of bank differently and it is regarded as one of the most important factors that decide the banks' performance (Zhou, 2000). In the following part, the two external factors are explained in detail.

### 3.8.1 Historical factors that influence the performance of shareholding banks

The NPLs are in a large extent a historical legacy. Huge number of NPLs has been a large contributor to explaining the poor performance in SOBs since the interests from loans have constituted the major part in banks' income in China.[18] With the deepening of reforming in financial system and the growing intensity of competition among commercial banks, the severe consequence of large amount of NPLs in SOBs gradually aroused the national-wide attention, especially after the burst of financial crisis in southeast Asia, Japan and South Korea. Shareholding banks, compared with SOBs, don't incur the problem as seriously as SOBs do. The different extent that the two types of banks have NPLs in some sense results from the institutional problem in China, namely, financing system in China and the government interference with SOBs. These two aspects will be illustrated.

*From the aspect of financing system*

Before the opening and reform in China, in order to establish and develop basic

[18] The intermediate services in China's four state-owned banks are still underdeveloped. The proportion of revenues produced by intermediate services fluctuates between 6.7% to 9.6% from 1994 to 1998. Compared with the figure in US, which is 39% in 1996, the figure in China is too small. Therefore, interest derived from loans still occupies great percentage in total revenues of banks.

industry and to meet the basic demand of people's living, the government appropriated a lot of funds from MOF to the SOEs. As a complement, the government also required banks to extend loans to SOEs, treating bank as a subsidiary of MOF.

Since 1983, the appropriation by MOF to SOEs was replaced by bank loans turning banks into the main fund-provider. From then on, these SOBs, actually fully assumed the responsibility of providing the SOEs funds for the use of fixed assets technological innovation and working capital. Under such financing system, the lending of loans was regarded as a political conduct rather than a commercial one. Therefore, when SOEs incurred huge loss, huge NPLs were formed in SOBs.

*From the aspect of interference from government*

The interference from government in extending loans is another vital reason to explain the large quantities of NPLs. When SOEs or government officials' relatives have some investment projects in need of funds, local governments will turn to the SOBs to urge them to extend "Notes loan" (which means that as long as the government officials signed on the notes, the bank should definitely extend the loan.) or "Face loan" (which means the reason that bank extend the loan is just because they don't want to lose the government official's face). The commercial banks were fully aware that once they extended the loans, they took the risk that they couldn't take back the loan any more. The government will not assume responsibility for those projects. In this case, large amount of non-performing loans in SOBs were formed.

In addition, to keep the stability of the society, the government tends to support some SOEs that are on the edge of bankruptcy for the sake of social stability. It is usually called "loans for social stability". Loans turn out to be a form of the social welfare. The right of SOBs is not protected and the number of bad loans is surely on the increase.

This situation was not greatly changed even when the 3 policy banks were established. So far, the three policy banks have only taken over a combined 1.40 trillion yuan (US$ 169.08 billion) in bad loans since 1999 while this figure is much smaller than the figure of NPL four SOBs owned.[19] As a result, SOBs still assume some part of policy loans of the state.

### 3.8.2 Current policy environment for banking industry in China

Policy environment are deemed as another factor that influences the performance of banks in China. The four state-owned banks and shareholding banks, as equal subjects in financial market, should be treated equally in the policy environment. However, currently the policies on the SOBs and shareholding banks are quite different. Different policies for the two groups of banks resulted in unfair

[19] The NPLs owned by the "Big Four" commercial banks stand at 1.8trillion yuan (US$217.6 billion) by the end of September, 2001. (China Daily, 1 November 2001)

competition and therefore influence the banks' performance.

In sum, there are two reasons that may explain this situation:

First, the PBOC is historically and closely linked with the SOBs. The four SOBs were separated from the PBOC and the relationship between them is just like the relationship between father and son. Correspondingly, there is constant exchange of staff and the exchange brings two parties closer. Especially, in the 1990's many positions in SOBs went to the relatives of the employees in different levels of the PBOC, which leads to close-knitted personnel relation. Thus, it is very hard for the PBOC to supervise the banks impartially.

Second, the four SOBs have much more profound effects on Chinese banking industry, and therefore call for more protection from government. In addition, there are huge amounts of NPLs in the four SOBs. Any problems in SOBs that are not tackled properly will result in financial risk and lead to turbulence in China's financial market and economy. Therefore, it is natural for the PBOC to adopt preferable policy to SOBs.

To sum up, the unfairness of supervision is reflected in the following two major aspects:

*Unreasonable restrictions are placed on shareholding banks' business scope*

Four aspects embody such unfairness:

1) Extra budgetary funds business

On June 11,1999, the MOF and PBOC jointly issued Regulation on the Management of Bank Accounts for Extra Budgetary Funds of Administrative Organs. The regulation stipulates that the account for extra budgetary funds of administrative organs should be opened in SOBs (Article 5). The policy has badly affected shareholding banks in two ways. On one hand, large number of deposits was transferred from shareholding banks to SOBs due to this stipulation; on the other hand, such stipulation caused public's distrust towards shareholding banks. As a result, it is much more difficult for shareholding banks to absorb deposit.

2) Financial aid in education and housing

(i) According to the Implementation of Income Tax on Interests of Saving Deposit, ICBC is the only bank assigned to deal with saving deposit on education exempted from tax on interests. (ii) ICBC is designated by the PBOC to solely deal with student loan enjoying fiscal subsidies; and (iii) only SOBs are allowed to conduct business in housing accumulation funds saving and housing accumulation funds loans. These stipulations have severely prevented shareholding banks from profitable business opportunities.

3) Business of loans collaborated by stocks

When it comes to loans collaborated by stocks, PBOC and CSRC had jointly stipulated that only the head offices of shareholding banks can conduct this kind of business. But such restriction does not apply to the four SOBs. The corresponding loss of accounts of capital liquidation has once again put shareholding banks into unfair competition.

4) Business for securities and investment funds

(i) The CSRC and the PBOC jointly stipulated that one security company can only choose one or two banks as liquidation banks. For the sake of convenience, security companies only choose those banks with broad network. Since SOBs have much more advantages in network, it is hard for shareholding banks to expand their liquidation business for security companies. (ii) According to Article 18 of the Interim Provisions on Management of Investment Funds, funds custodian should have paid-up capital of not less than 8 billion RMB. Such regulations actually prevent shareholding banks from conducting such business.

*Unfairness in policy of solving non-performing loans*

As we explored in the above, due to historical legacy large number of NPLs has been accumulated in SOBs. In order to improve the financial condition, three policy banks and four AMCs were set up, which have moved dramatic burden from the four SOBs.

Although shareholding banks have a smaller number of NPLs, -- by the end of 1999, it totaled 140.989 billion RMB, the NPL rate is still high compared with foreign banks in world. However, shareholding banks don't have governmental support in dealing with NPLs. In most shareholding banks, the usual practice in dealing with those bad assets is to draw reserve amounting to 1% of outstanding loans. Such regulation doesn't disclose the true risk that shareholding banks face and therefore cannot help them to control and deal with the potential credit risks. In addition, shareholding banks cannot set up their own AMC, in contrast, the four state-owned banks establish such institution with the support from government.

In sum, external factors (historical burden and current policy environment) complicate the comparison of two types of banks' performance. Historical factors tend to explain why SOBs perform poorly, while current policy factors tell us that SOBs are enjoying a preference policy from government. The preferential policy has attempted to help SOBs to gain more profitable business, which is forbidden to shareholding banks; and help SOBs to deal more efficiently with the bad loans, while shareholding banks are not able to gain governmental support like that.

## *3.9 Conclusion*

The comparison of performance between the SOBs and shareholding banks shows that shareholding banks perform better than SOBs. Regression analysis done with the specific context of China further indicates that organization form – whether it is shareholding or wholly-state-owned plays a significant role in explaining the difference in bank performance. However, when examining the performance of both groups of banks from external factors' perspective, we get a rather blurring picture since the policy influence and treatment of both types of banks seem to trade off advantages and disadvantages. Thus, in the next chapter, we will investigate the internal factors -- corporate governance, personnel management, incentive mechanism, and credit management – to explain the difference in performance in the two groups of banks.

# Chapter 4 Corporate governance and credit management underlying bank performance

## 4.1 Introduction

The results of the quantitative analysis in Chapter 3 tend to confirm that ownership structure is a significant factor in explaining the difference of performance between shareholding banks and SOBs. However, the quantitative analysis has its defects. The accounting data are not consistent among banks and not consistent through the period that we used in regression model.[20] The inconsistency in data has made it difficult to compare performance among different banks and even performance of one bank between different years. As such, the difference in performance between the two types of banks has been explained by the external factors: historical legacy; and legal and policy environment. Historical legacy explains shareholding banks have performed better than shareholding banks; whilst government policies are in favor of SOBs.

In this chapter, the difference in performance of the two groups of banks will be explained by their internal factors: organizational and managerial perspectives. More

[20] In China, the accounting system has not been well established. Each bank employs its own accounting principles and in the past ten years, China's banks have experienced several accounting reforms while no adjusted data can be obtained in publications. For example, the earning of CCB for year 1997 is 1.878 billion yuan in 1998 Almanac while the figure is 1.118 billion yuan in 1999 Almanac. Another example is from shareholding banks: the earning of CMB for year 1998 is 1.399 billion yuan in 1999 Almanac while the figure is 1.514 billion in 2000 Almanac.

specifically, the corporate governance of banks, personnel management and incentive mechanism, and credit management will be discussed.

To get a deeper insight into the three issues and gain an overview of Chinese banking industry,[21] the author has conducted interviews with senior bank managers in March 2001. Ten banks in four cities – Beijing, Shanghai, Guangzhou and Shenzhen were visited. The questions asked in the interviews were put in a questionnaire, which can be referred to in Appendix 2. Briefly, the questionnaire focuses on four aspects of Chinese banking industry. First, the policy and legal environment for banking industry in China. This part refers to the policy and legal environment issues we discussed in Chapter 3. Second, the organization structure and corporate governance of both state-owned banks and shareholding banks. Third, the credit and risk management. These two issues serve to give a clearer picture of corporate governance, personnel management, incentive mechanism and credit management issues we are going to discuss in this chapter. The last part is on the future trends for banking development in China and it helps us to examine how the senior managers see the future trend of Chinese banking industry. On the basis of the information collected through the interviews, we discuss these issues in this chapter and Chapter 5. The details on how the interviews were conducted are given in Appendix 1 and Appendix 2.

[21] External factors refer to the policy and legal environment; while internal factors refer to corporate governance, credit management etc.

This chapter has three parts. First, the corporate governance in SOBs and shareholding banks is discussed. This is followed by a comparison of their personnel management and incentive mechanism. Finally, the credit management, mainly the procedure of granting loans is described and a conclusion is drawn.

## *4.2 The corporate governance of two groups of banks*

### 4.2.1 Theoretical analysis of the agency relationship in SOBs

An agency relationship, in the words of Jensen and Meckling (1976, p.308), is

"A contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some services on their behalf which involves delegating some decision-making authorities to the agent. "

The agency relationship leads to the separation of ownership (principals who provides the finance) and control (agents who are granted decision-making authority by principals). In a more intuitive terminology, the separation of ownership and control is the separation of finance and management (Shleifer and Vishny, 1997). According to Jensen and Meckling (1976, p.308), as long as both parties are utility maximizers, the agent will not always act in the best interests of the principal. Therefore, principals should adopt some measures to assure that their funds are not expropriated or wasted on unattractive projects. Corporate governance is a mechanism which refers to "the way in which suppliers of finance (principals) to assure themselves of getting a return on their investment" (Shleifer and Vishny, 1997).

The agency relationship is very common in human society. It exists in all organizations and in all co-operative efforts, at every level of management in firms, in co-operatives and in government activities, etc. (Ibid., p.309). Agency relationship also exists in state-owned enterprises. In state-owned enterprises of the socialist economy, it is claimed that "the whole people" is the owner of the enterprises. Since "whole people" is an abstract concept, government claims to execute the owners' right on behalf of "the whole people". However, government as an organ cannot manage the business. Therefore, government designates some officials to be in charge of the business. In such circumstance, double agency relationships are formed. First, government acts as the agent for the "whole people"; second, the officials appointed by government serve as the agent for government. In the two agency relationships, both principals are non-personified for neither "whole people" nor government is a real person. As a result, actually no real person provides funds in state-owned enterprises and thus no one has the impetus to establish an effective corporate governance to assure that the agent will act in the best interest of the principal. The lack of effective corporate governance has caused huge agency cost and led to the inefficiency of state-owned enterprises.

Shareholding reform as a way to establish effective corporate governance is greatly advocated. Liu (1991) argues that through transforming state-owned enterprises into shareholding entities, the owner is not an abstract concept any more. The owner can be individuals, institutional investors and other forms of enterprises. In this sense, the owner is "personified" and thus has the incentive to establish effective corporate governance.

The shareholding entities can provide effective corporate governance by establishing an inter-discipline mechanism consisting of three functioning organs. The three organs are: the shareholders' meeting, the Board of Directors and the Board of Supervisors.

The shareholders' meeting is on behalf of owners' interest. Its major role is to nominate the members of the Board of Directors and make decisions on issues such as shares issuing. It is held twice a year. The Board of Directors follows the will of shareholders' meeting and is responsible for decision control (ratification and monitoring). The Board of Directors' major functions include "recruitment, appointment, monitoring, and dismissal of managers; examination and decision-making about annual plans and long term development strategies; and deciding on the distribution of dividends and the remuneration of managers" (Mok and Leung, 2000). The Board of Supervisors in Chinese shareholding entities is a functioning organ responsible for auditing the major policies, long-term strategies of the Board of Directors and daily operational activities at managerial level. Its purpose is to protect shareholders' interest and assure that enterprises will develop at shareholders' will so as to realize the maximized profits.

It is also claimed that enterprises could be transformed into shareholding entities by dividing ownership into shares and have the shares transferable on the stock market. Enterprises can establish disciplinary mechanism and exert pressure on managers (agents) to keep good performance in stock market, by establishing a market for corporate control and by introducing institutional investors and their monitoring.

From the analysis, shareholding entities could improve the effectiveness of corporate governance, strengthening the monitoring of agents and thus improving the performance of enterprises. The advantages brought by shareholding entities also apply to banks, which can be regarded as one type of enterprise.

Then how is corporate governance undertaken in shareholding banks in China? How are the SOBs organized? In the following section, we will first examine the organizational structure of SOBs in an attempt to identify the problems in such corporate governance. Second, the corporate governance of shareholding banks in China will be discussed. Finally, we will discuss the characteristic problems in corporate governance rooting in Chinese shareholding banks.

**4.2.2 The organizational structure of SOBs**

Separated from PBOC, the four SOBs are all under the leadership of MOF and PBOC. The MOF, which acts for government, has 100% ownership of the SOBs. The China Finance Party Union (CFPU), [22] a governmental administration responsible for senior appointments, cooperates with MOF in supervising the management of SOBs. Chart 4.1 describes the corporate governance of SOBs.[23]

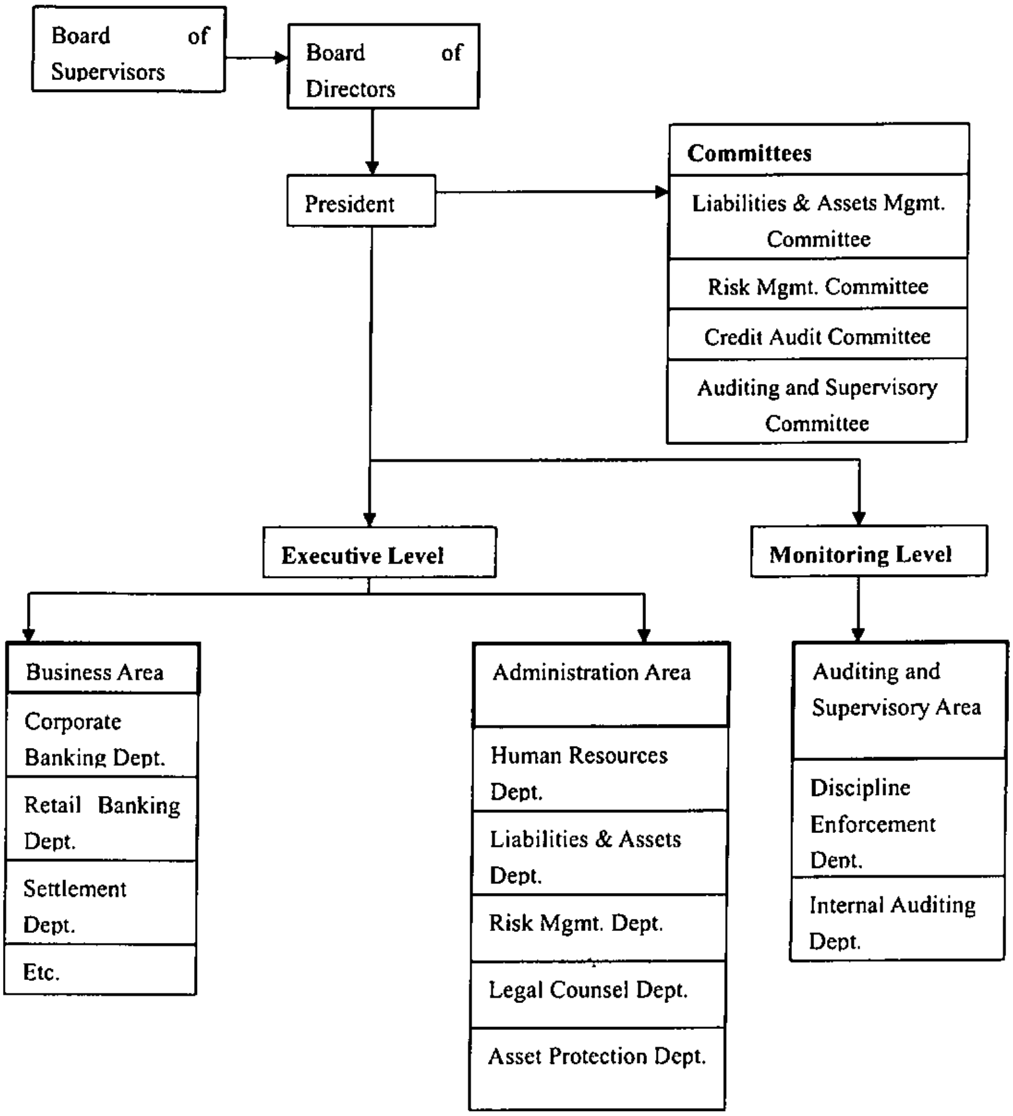
From Chart 4.1, we can see that the Board of Supervisors and the Board of Directors constitute the corporate governance in SOBs. The selection of both board members is not through shareholders' meeting but directly through MOF, which exclusively owns SOBs. What's more, some of the board members are appointed by CFPU and other governmental administrations. As a result, the board members are closely linked with government and lead banks to manage at government's will. What's more, the board members nominated by government have no direct interest in the performance of SOBs, they cannot really perform their tasks of controlling decisions and auditing management. This has to a large extent explained why SOBs are seriously interfered by government and the board members' indifference to banks' performance. The ineffective corporate governance in SOBS may explain their worse

[22] Chinese Finance Party Union is a Party organ, and serves to assure all the financial institutions of following the route and principle of the Party by supervising the senior personnel appointment in financial institutions.

[23] Due to the fact that the four SOBs were all separated from PBOC, they follow the same tradition and adopt the similar organizational structure. Chart 4.1 is a generalized structure based on those four SOBs.

performance compared with the shareholding banks'.

**Chart 4.1 The organization structure of SOBs**



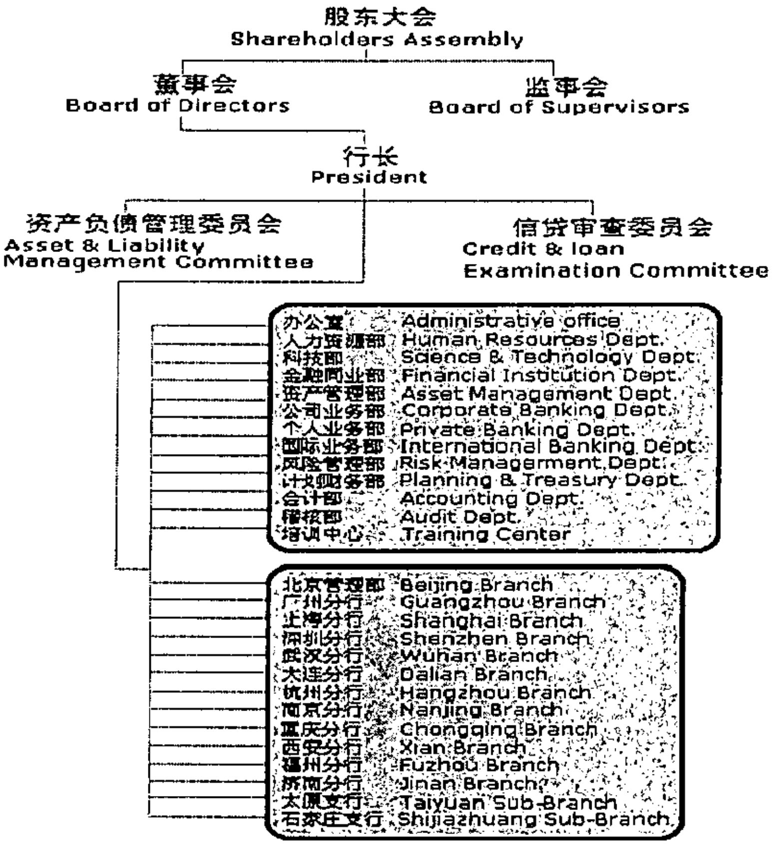

Source:

Bank of China website: http://www.bank-of-china.com/

### 4.2.3 The corporate governance of shareholding banks

As we may see in Chart 4.2, the corporate governance in a shareholding bank consists of the shareholders assembly, the Board of Directors and the Board of Supervisors. Under such a system, the shareholders concern about their return and therefore they elect the Board of Directors who can serve them best. The Board of Directors on behalf of shareholders' interest pursues maximized profit. The Board selects top managers to manage corporate business and in the meeting of Board of Directors they draw up long-term strategies. Under such a mechanism, the career of

**Chart 4.2 The organizational structure of China Minsheng Bank**




Source:

China Minsheng Bank website: http://www.cmbc.com.cn/

managers is no longer determined by state bureaucracy but by their efforts to maximize profit (Perkins 1994). In addition, shareholders can exert hard budget constraint on managers by trading shares. The rise and fall in stock prices become a good measure to press the top managers to maximize their bank's profit. The function of the Board of Supervisors is to supervise and regulate corporate management and protect shareholders' interest.

Take China Minsheng Bank Corporation (CMBC) for example, CMBC is the first shareholding commercial bank with shareholding structure with a capital participation dominated by the non-state owned enterprises. Table 4.1 shows the 10 largest shareholders of CMBC. "The founder, Jing Shuping, was hailed as a genuine banking entrepreneur from outside the communist system, and the bank became the first of what may soon become a wave of private banks." (Lancher, 1996). On December 19, 2000, CMBC succeeded in listing in A shares on Shanghai Securities Exchange, and ever since entered into the Chinese capital market.

Since its establishment, CMBC has attached great attention to the corporate governance construction and practice of internal regulations. From Chart 4.2, we can see that different from SOBs, the Shareholders' Assembly, Board of Directors and Board of Supervisors constitute an interdisciplinary mechanism. The Minsheng Charter sets a balanced mechanism of rights for the Board of Directors, the Shareholders' Meeting and the Management in important decision-making, and defines the voting as the primary mode of decision-making. Therefore, the Board of Directors, the Board of Supervisors and the Management are able to play their own roles and fulfill their own responsibilities respectively.

**Table 4.1 Largest ten shareholders of CMBC**

| Name of shareholders | Number of shares owned | Percent of ownership |
|---|---|---|
| Sichun New Hope Agriculture Limited Company | 179,426,000 | 7.98% |
| China Fanhai Holding Company | 169,000,000 | 7.51% |
| East Hope Group | 169,000,000 | 7.51% |
| China Shipowners Mutual Assurance Association | 143,000,000 | 6.36% |
| China Town-Village Enterprises Investment & Development Company | 130,104,000 | 5.78% |
| Xiamen Fuxin Group | 123,890,000 | 5.51% |
| China National Coal Industry Import&Export (Group) Corp. | 117,000,000 | 5.20% |
| China Nonferrous Metal Industry's Foreign Engineering and Construction Corporation Ltd. | 117,000,000 | 5.20% |
| Beijing Vantone Industry Co., Ltd. | 96,278,000 | 4.28% |
| Sichuan Southern Hope Limited Company | 84,474,000 | 3.76% |

Source:

China Minsheng Bank website: http://www.cmbc.com.cn/ (February, 2002)

All the largest ten shareholders listed in Table 4.1 are non-state enterprises. Owned by non-state enterprises, CMBC is unique in its operation doctrine of "Serving the Public and Feeling the Minsheng". Unlike the four SOBs that take SOEs as their major customers, CMBC takes the non-state owned enterprises (NSE), small and medium-sized enterprises (SME) and high-tech industries as its targeted customers. According to data from CMBC, in terms of customers, 90% of CMBC customers are classified as SMEs; while in terms of lending, 60% of its loans are provided to the SMEs and NSEs. Currently, CMBC is engaging in the activity of "Long March of Financial Promoting Scheme for Small and Medium-Sized Enterprises". It provides a series of products including bill discounting, guaranteed loans, lending against tax refund in export and interest discount lending to high-tech enterprises for the development of the NSEs. The case of CMBC fully shows that under the shareholding mechanism, the "personified" shareholders have the impetus to establish effective corporate governance. The type of shareholders will determine the operation and management strategy of banks. For SOBs, under the leadership of MOF (on behalf of government), they are controlled by government's will and therefore choose more SOEs as their customers. For shareholding banks such as CMBC, the leadership is in the Board of Directors who make decisions on behalf of shareholders' will. The Board will choose those customers who will bring them huge profits since shareholders' major goal is to maximize profits and thus the Board has more incentive to improve bank performance.

The above comparison helps us to conclude that with Shareholding Assembly, Board of Directors and Board of Supervisors, shareholding banks are more commercialized in choosing customers and less influenced from government than the SOBs. With such corporate governance, shareholders can more easily supervise managers' activities, reduce agency costs and on the basis of it, improve the performance of banks.

However, could the corporate governance for shareholding banks get rid of problems rooting in SOBs? From our interviews, it seems that the corporate governance in shareholding banks have some "Chinese characteristics" and produce some problems similar to those in SOBs. In the following section, we will discuss the problems underlying the shareholding banks.

### 4.2.4 Problems underlying corporate governance in shareholding banks

Though shareholding entities have brought a lot of advantages that SOBs do not have, it is agreed that shareholding banks in China are not real shareholding banks when compared with those in western economies. By saying so, we mean that though they are organized as shareholding entities, the controlling shareholders of shareholding banks are levels of government or SOEs. As a result, problems rooting in SOBs to some extent lie in shareholding banks.

Table 4.2 gives the largest shareholders of shareholding banks. The largest shareholder refers to shareholder who holds the biggest percent of shares in the bank. From Table 4.2, we can see that except China Minsheng Bank whose largest shareholder is a non-state enterprise; all other shareholding banks have their shareholders dominated by levels of government and SOEs. Although the controlling

**Table 4.2 Largest shareholder of each shareholding bank**

| Bank | Largest Shareholder | Nature of the Largest Shareholder |
|---|---|---|
| Bank of Communications | Ministry of Finance | Central government |
| Shanghai Pudong Development Bank | Bureau of Finance (Shanghai) | Local government |
| Fujian Industrial Bank | Bureau of Finance (Fujian) | Local government |
| Guangdong Development Bank | Guangdong Provincial Government | Local government |
| Shenzhen Development Bank | Shenzhen Investment & Management Company | Enterprise wholly owned by local government |
| Huaxia Bank | Shougang Group | SOE |
| China Everbright Bank | Everbright Group | SOE (Directly led by State Council) |
| CITIC Industrial Bank | China International Trust & Investment Corp. | Group established by Rong Yiren, the former vice-chairman of PRC |
| China Merchants Bank | China Merchants Group | SOE (Directly led by Ministry of Transportation) |
| China Minsheng Bank | Sichuan New Hope Agriculture Limited | Non-state enterprise |

Source: The websites of all the banks above, March 2002.

shareholder of Minsheng Bank is a non-state enterprise, its board chairman, Mr. Jin Shuping, is the Chairman of Great China Industry & Commerce Federation and the vice-chairman of the Chinese People's Political Consultative Conference and will more or less represent governmental will in bank's decisions.

Therefore, we can conclude that the shareholding banks are still under the control of the state. Then how does it affect the corporate governance in shareholding banks? It is believed that shareholding banks incur similar problems lying in SOBs, namely no "personalized" owner problem and its associated problems.

Due to the structure of shareholders, highly centralized and dominated by state, the management and operation of shareholding bank are directly or indirectly under the control of government.[24] The public and non-state-owned shareholders do not have enough impact in the decision-making process. Though shareholders' annual meeting was held, few individual shareholders participated in the meeting. Even if they did, they couldn't have their voice heard. Consequently, the decisions of the shareholders meeting turn out to be the wills of the state and government. Therefore, the problem of SOBs have arisen from shareholding banks, i.e. who shall exercise shareholders' rights on behalf of state shares and legal person shares?

[24] Though controlling shareholders of some banks are SOEs, since SOEs are wholly owned by government, as a matter of fact government controls the banks.

Officials from government who are appointed to shareholding banks do not care much about the interest of their banks since their personal interest is related to political performance. "...Top executives owe their livelihood and positions to government. In spite of outward features (such as titles and job descriptions) that seem to correspond to their western bank counterparts, these executives are, in essence, political appointees and they owe their loyalties to the traditional power structure of the party and government apparatus..." (Li, Liu, Liu and Whitmore, 2001). In most circumstances, banks become tools for local government to realize its political goals. For example, government-established banks usually become treasury of local governments to support local economic development. It is pointed out that a certain bank invests 70% of its deposits collected from other provinces to support its local projects.

The disconnected interest between shareholders and banks also result in shareholders' indifference to long-term development of banks. When shareholders of banks are those SOEs who are financially in trouble, shareholders attach more attention to SOEs rather than banks since their political interests are more directly related to SOEs than to banks. In such circumstances, shareholders will sacrifice banks' interests (especially long-term development) for the sake of short-term SOEs' performance. For example, some SOEs will require banks to distribute more profits so as to make up the loss of SOEs, while the profits were supposed to be allocated to long-term development for the banks.

The direct and indirect control by government also brought problems of choosing top managers of banks. Currently, the appointment of the President of a bank must be both approved by PBOC and CFPU. Article 15 of Chapter 4 of Provision on Management of Senior Managers in Financial Institutions,[25] states that PBOC is responsible for verification, approval and removal of senior managerial personnel in financial institutions. In other countries and regions, it is a practice that regulatory authority shall only examine qualifications of the senior nominees proposed by banks rather than interference and even proposing candidates it prefers. However, there is a chance that PBOC will reject the nominee and propose a new one, while usually a bank won't reject the nominee that PBOC proposes. Top managers elected in this way are more concerned about their political performance and short-term performance of the banks, and are indifferent to their long-term development.[26]

The Board of Directors does not perform its function enough as well. Contrary to practice in western countries, in Chinese shareholding banks, managerial level possesses much more power than shareholders and the Board of Directors. Significant decisions are decided by managerial level and many top managers are simultaneously members of the Board of Directors. The Board of Supervisors is in

[25] It was promulgated in March 2000 by PBOC.

[26] This is due to the fact that the duration of senior managers is not long (usually 2 to 5 years), and they will not be responsible for the problems that happen after they leave the bank. Therefore, they are more inclined to improve the short-term performance of banks while sometimes sacrifice the long-term development of bank.

an awkward situation as well. It is a special organ in Chinese corporate governance, for in most countries the Board of Supervisors doesn't exist. In China, the Board of Supervisors is responsible for shareholders and supervises the daily activities of directors and senior managerial personnel of the bank, preventing any act harmful to the right and interest of shareholders. However, because of the absence of owner, there are no concrete shareholders to whom the Board of Supervisors should be responsible to, the supervision is just a formality and the Board of Supervisors is just a nominal organ.

## *4.3 Personnel management and incentive mechanism in two groups of banks*

Though there are still some problems of corporate governance lying in Chinese shareholding banks as we have discussed above, it is undeniable that shareholding mechanism brings better corporate governance to banks. And better corporate governance drives shareholding banks to have clearer operation and management goal – make more profits for shareholders. The goal of pursuing profits has made shareholding banks adopt more market-oriented personnel management and incentive mechanism, which have been considered as competitive advantages of shareholding banks. As to personnel management, SOBs still use the management mechanism that is employed in government. The recruitment procedure of employees is not as transparent as that of shareholding banks. Connection (Guanxi) plays an important role in this procedure. Once employees are recruited, they cannot be degraded or their employment terminated except that they committed political mistakes. The criteria to promote people are duration of service and political performance, little to do with talents and work performance.[27] The personnel management in shareholding banks is more market-oriented. The shareholding banks have greater flexibility in employing qualified staff and reward them with market remuneration.

Incentive mechanism is considered another advantage that shareholding banks possess. With a profit-oriented principle, shareholding banks are expected to have a better incentive mechanism to motivate their staff to perform better. The pay to their employees is not only based on the title or position but also on work performance of each employee. While in SOBs, the incentive mechanism is relatively inflexible since the job title has almost decided their income while work performance is not an important factor on one's income. More discussions about personnel management and incentive mechanism are given in the following sections.

### 4.3.1 Personnel management in two groups of banks

As we have stated above, one of the most prominent problems in personnel management in SOBs is that once a person is employed, he cannot be demoted or

[27] Political performance here refers to whether the employee is loyal to communist party and whether he makes contributions to Party. Since political performance is very subjective, many senior managers that I interviewed deemed that it was dependent on the connection (Guanxi) with high officials. The better Guanxi with high officials, the much more possibility that one can be promoted even if one does not have outstanding performance in business.

contract terminated unless he commits serious political mistakes. This problem in large extent has led to the fact that four SOBs have large number of redundant employees and branches.[28] What's more, SOBs have the responsibility for financially supporting employees after their retirement.[29] Therefore, SOBs have been burdened with huge costs resulting from the personnel system and are inevitably less efficient and much less profitable.

To get an insight into personnel management of SOBs, we first investigate their recruitment procedure. In China, a job in a bank is considered as a "golden-bowl" which stands for stable, well-paid and decent social status. Therefore, many governmental officials tried to arrange their relatives or close friends to work in banks. Since government heavily influences SOBs' decisions, and the latter cannot afford to offense officials, SOBs have to recruit a large number of employees because of *Guanxi* and most of the employees are not qualified enough. A good indication ratio is the education level of employees in two groups of banks. Those who get jobs in SOBs through Guanxi always have a lower educational qualification. Table 4.3 shows the percentage of staff with at least post-secondary education in SOBs. From this table, we can see that the educational level of more than half of the employees in SOBs was lower than post-secondary education. When banking

[28] According to Almanac of China's Finance and Banking (2000), by the end of 1999, ICBC, ABC, BOC and CCB respectively owned employees 541,525, 527,740,196,466 and 318,898. While during the same period, shareholding banks such as Bank of Commutations only own 45,386 employees and other smaller banks such as Huaxia Bank owned 3,345 employees.

[29] The financial support covers living cost, medicine and insurance fees, as well as gift distributed on tradition holidays such as Spring Festival.

services were still simple and SOBs were not commercially driven, employees with lower education level didn't pose a big threat. However, when competitions were introduced and operations of banks were commercialized and modernized, the low educational level of employees became big headaches for SOBs to compete with shareholding banks and foreign banks since their employees' lower educational qualification does not equip them with adequate knowledge. On one hand, SOBs are in great need of high-quality employees, on the other hand, SOBs are more burdened by large surplus of low quality employees. However, SOBs always hesitate to take any reform measures in cutting down their employees.

**Table 4.3 Percent of SOBs' staff with at least post-secondary education**

| | 1996 | 1997 | 1998 |
|---|---|---|---|
| ICBC | N.A. | 34.6 | 38.99 |
| ABC | 24.3 | 27.8 | 32.05 |
| BOC | 41.3 | 44.9 | 48.6 |
| CBC | 41.2 | 44.5 | 48.8 |

Source: Wong and Wong (2001), p.37.

Then how do SOBs manage employees once they are hired? From the interviews, we learned that no matter in the appointments of senior or inferior managers, government plays a direct or indirect role in the whole procedure.

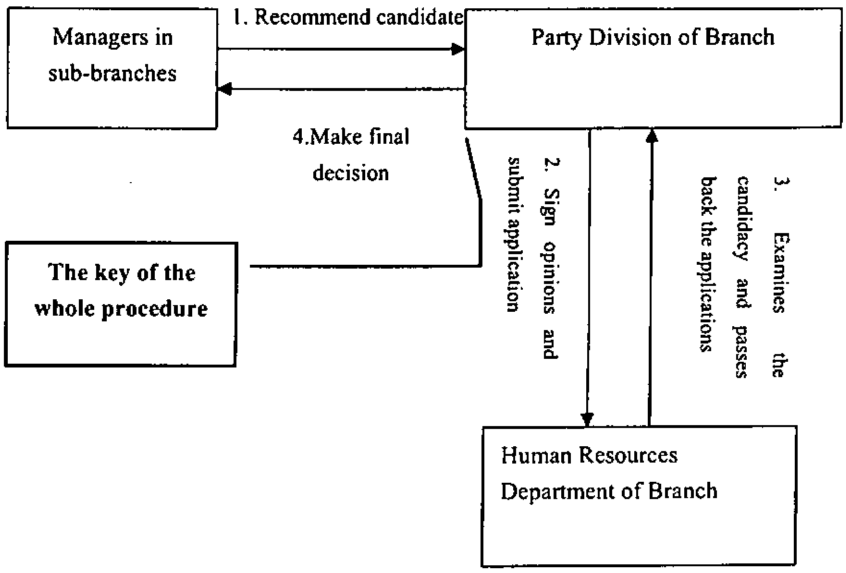
*The personnel management in SOBs -- Appointment of senior personnel*

With regard to appointment of senior bank manager the State Council plays an important role. We will use two examples to explain the role of the State Council. The first example is the senior personnel appointment in SOBs in 2000. It was conducted directly by the State Council. The top managers were either transferred from one SOB to another SOB or from SOB to regulatory authority such as PBOC or CSRC. For example, Mr. Wang Xuebin, the former president of Bank of China, was appointed the President of China Construction Bank. Mr. Zhou Xiaochuan, the president of China Construction Bank, assumed the president of CSRC. The second example to demonstrate the role of the State Council is the dismissal of Mr. Wang Xuebin in the beginning of 2002. Mr. Wang Xuebin, both the President of China Construction Bank and the member of Central Committee of Chinese Communist Party, was dismissed and his dismissal was approved by the Central Committee of the Party and the State Council. From the two examples, we can see that the appointment of senior bank employees was rather a political behavior. Each SOB should accept the senior appointments of the State Council and it is impossible for SOBs to choose or dismiss top managers of their own choice.

*The personnel management in SOBs -- Appointment of junior personnel*

The personnel management of junior employees in banks is influenced by government and is inflexible as well. It usually took more than one month to promote a junior employee[30] and such procedure was almost the same as the one in government. Chart 4.3 illustrates the procedure of promoting junior employees in China Construction Bank (Nanping Branch). We take it as an example to show the procedure in SOBs.

**Chart 4.3 Procedure of promoting junior managers in sub-branches of SOBs**




Source: Human Resources Department of China Construction Bank (Nanping Branch).

As illustrated in Chart 4.3, first, the managers of a sub-branch will recommend candidates to the Party Division.[31] The Party Division needs to endorse with comments the application materials. Second, the Party Division will submit the

[30] The duration is too long compared with the one in shareholding banks. It only takes two to three weeks to promote a junior employee in shareholding banks.

[31] Party Division is a necessary division in SOB and it is in behalf of government's will.

application with its opinions to the Human Resources Department. This department is responsible for examining the candidates' personality, capability, diligence and accomplishment. In fact, the examination is not so meaningful for two reasons. 1) The department usually will follow the opinion from the Party Division. 2) It is hard to examine the candidates' personality, capability and diligence since the criteria are very subjective. All the department can do is to investigate whether the candidates have committed any political mistakes. Since usually people will not commit political mistakes, the department just follows the opinions of both the sub-branch and the Party Division. After Human Resources Department examined the candidates' qualities, it will pass the results to the Party Division for making the final decision. And finally the Party Division will release the result to the sub-branch. Obviously, through the whole process, the Party Division is the key of the procedure. Its decision determines whether a candidate can be promoted or not. Essentially the Human Resource Department doesn't have any authority to change the decision and since the Party Division reflects the will of government, we can conclude that even the management of junior managers is not market-oriented and therefore inefficient.

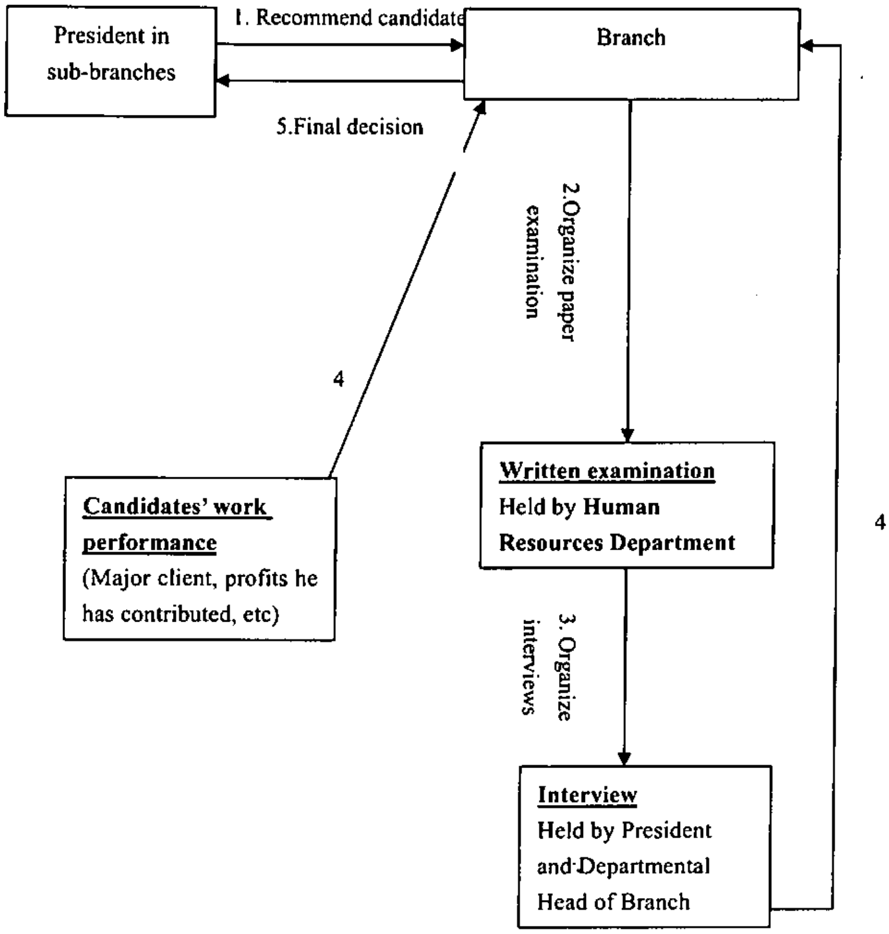
*The personnel management in shareholding banks*

Shareholding banks, contrasted to SOBs, have much more flexibility in personnel management. To increase their competitiveness, shareholding banks adopt a more transparent recruitment process, aiming to employ more talents. The shareholding banks can easily demote or stop employing those who are not efficient in their work and promote those who perform excellently and have potentials to do better. If the president of a tier-two sub-branch wishes to promote an employee to be manager of a department in a tier-two sub-branch, he only needs to submit an application to the president of tier-one sub-branch and he would make the final decision. If he wishes to promote an employee to a position higher than manager of a tier-two sub-branch, he should follow the procedure described in Chart 4.4.

First, the president of a sub-branch should recommend candidates to branch. Then the Human Resources Department will organize a written examination to test candidates' commercial banking knowledge, familiarity with hot social issues, specialized English, and etc. After the first round selection, the Human Resources Department will list candidates for second round interview. The interview panel consists of the President and Departmental Heads of branch. Finally, the interview results together with a candidate's work performance will decide whether he will be promoted or not.[32]

[32] Work performance includes many criteria such as the quality of candidates' major clients (number of profits the enterprise can bring to bank), the number of deposits he absorbed and number of good quality loans he won for the bank and etc.

**Chart 4.4 The procedure that shareholding banks promote junior managers in sub-branches**




Source: Interviews in China Merchants Bank

*Conclusion on comparison of personnel management in SOBs and shareholding banks*

From the above comparison of shareholding banks and SOBs, we can find that shareholding banks have more flexibilities and use more market-oriented methods in their personnel management. The shareholding banks can recruit and promote people that are really competent and they do not have the pressure to maintain employees for the sake of social stability. The shareholding banks are less interfered by government and the procedure to promote employee is more market-oriented. In SOBs, they use personality, capability, diligence and accomplishment. All these criteria are hard to define and very subjective. While in shareholding banks, written examination and interviews are organized and work performance is evaluated by some objective criteria. Therefore, the whole process of staff promotion in shareholding banks is more transparent, fair and efficient.

In sum, the more market-oriented personnel management in shareholding banks has won more competent employees to work for them and therefore increased their competitiveness in the banking industry.

### 4.3.2 The incentive mechanism in two types of banks

Incentive mechanism has an important impact on employees' morale. A good incentive mechanism can stimulate employees' passion to do their work better and correspondingly improve bank performance. Then what is the difference of the incentive mechanism between the two groups of banks?

Incentive mechanism consists of salary, bonus, stocks, options and etc. while salary and bonus are the two most common ways to stimulate employee morale.[33] From the interviews, we learned that the structure of employees' income is similar in each group of banks. In both the SOBs and shareholding banks, income consists of two parts: basic salary and bonus. The basic salary, which is relatively fixed, mainly depends on an employee's duration of services and job position. Bonus is determined by an employee's performance. This does not mean that the two groups of banks have the same incentive mechanism. The difference is in the way that they evaluate an employee's performance.

In SOBs, the philosophy to evaluate a person's performance is that "Wu guo bian shi gong" (Chinese pinyin) -- It means, "as long as people commit no mistakes, they should be credited with making achievement." What's more, as we have mentioned before, SOBs do not set objective criteria to evaluate one's work performance. Under such circumstance, the evaluation of performance turns into a formality. Since usually people will not commit serious mistakes, they should obtain the similar bonus. As a result, once a people's title is set, he will receive almost the same income no matter how well he performs. This kind of incentive mechanism has largely damaged employees' morale and therefore does harm to bank performance.

[33] Stocks and options are widely used in western economies, which aim to link up the employees' pecuniary interest with the long-term development and profit-maximizing goal of the company.

In shareholding banks, the evaluation of performance is closely linked with each employee's quantified work performance. Work performance in shareholding bank can be assessed for example by number of tasks accomplished by an employee every month.[34] The more tasks one accomplished, the more one will get. Usually at the beginning of each month, employees are assigned tasks and managers encourage them with such the philosophy: "Wu gong bian shi guo." It means, "as long as people do not make any contribution and achievement, they should be considered as making mistakes." Under such a mechanism, employees are encouraged to accomplish tasks as many as they can so as to be rewarded with higher pay and banks' performance is greatly improved. Asides from salary, shareholding banks use other incentives such as rewarding employees with stocks and dividends while these means can not be used in SOBs since they are not shareholding entities and do not have stocks. In addition, some shareholding banks have invented unique ways to stimulate employees' morale. For example, CMBC had undertaken the construction of the "Three Cards" project. The project is composed of "the Welfare Card", "the Performance Card" and "the Training Card". The welfare card is used to assure staff with all concerns, the performance card to record the contribution of staff in value, while the training card taps the potentials of staff, so as to reshape the staff's career path.

[34] The tasks may include the number of deposits that employees should attempt to absorb. This principle applies to staff in business departments such as corporate banking department, and retail banking department. For staff in charge of administration jobs, their performance depends on the number and nature of mistakes they commit. The fewer and less serious mistakes they commit, the better performance they have.

The range of salary of employees in each group of banks is also different. Unlike the shareholding banks, the level of salary in SOBs is determined by MOF because SOBs are state-owned and its salary system must follow the rule in government. We can see the big difference in salary between the two types of banks in Table 4.4.

**Table 4.4 Monthly salary comparisons between two groups of banks in Shenzhen**

| Type of banks / Job title | SOBs | Shareholding banks |
|---|---|---|
| Common employee | 1,000—2000 | 3,000—5,000 |
| Head of Department | 2,000—3,000 | 6,000—8,000 |
| President of sub-branch | 3,000—4,000 | 9,000—10,000 |

Source: Interviews in Shenzhen, July 2001

The different incentive mechanisms have resulted in loss of talents in SOBs. The talents' movement from SOBs to shareholding banks has accelerated the development of share-holding banks by bringing business skill, good customers and creativity. The interviewee from Bank of China emphasized the importance of a good incentive mechanism by relating the story of Universal Card, the most popular personal banking product in China. The Universal Card has brought China Merchants Bank huge profits and big market share and enabled the bank to top third largest bank in China within just 5 years. Mr. Chen, the interviewee, stressed that the designer of Universal Card was originally an employee in Bank of China and recruited by China Merchants' Bank with 5-6 times higher salary. The reason why the person didn't design such a profitable product in Bank of China is just because under the incentive mechanism in Bank of China, he had no desire to do better. He has greater financial incentive to do so in a shareholding bank. Mr. Chen added that there were a lot of talents in SOBs, but if the incentive mechanism could not be reformed in time, more talents would leave for shareholding banks and foreign banks. The loss of capable staff will inevitably has negative effects on the performance of SOBs, that is the loss of good customers, creativity and eventually the loss of profits.

In sum, better corporate governance has brought shareholding banks more flexible and market-oriented personnel management and incentive mechanism than SOBs. The more market-oriented management and mechanism in shareholding banks have enhanced employees' morale, stimulated their creativity, increased the number of capable employees and eventually brought competitive advantages to create a better performance than SOBs.

## *4.4 The comparison of credit management in two types of banks*

### 4.4.1 Importance of loan management and bank performance

Compared with foreign banks, banks in China have much fewer banking products and narrower business scope. As a result, most of banks' profits come from interest income. Table 4.5 and Table 4.6 show the asset structure of the four SOBs and the ratio of interest income to gross income respectively. From Table 4.5, we can see that SOBs invest most of their assets in loans while securities only take up a small proportion.[35] From Table 4.6, the ratios of interest income of all the four SOBs range from 70% to 90% even at the end of 1990s and it shows that interest from loans still occupies a great percentage in total revenues of SOBs. Since SOBs dominate the banking industry of China in terms of assets, capital, loans and deposits, we can conclude that loans are still taking a large percentage of banking assets and interest income still dominates banks' income. The other evidence for the important role of loans is the lower percentage of profits from intermediary services in the total profits of Chinese banks. Jiang (1999) argues that in the United States, the proportion of revenues from intermediary services rise from 22% in 1980 to 39% in 1996. However, in China, the figure fluctuates between 6.7% in 1994 to 9.6% in 1998 in SOBs.

Therefore, the quality and profitability of loans in banks directly affect the performance of the two groups of banks. In this sense, the management of loans is of vital importance in understanding performance of the two types of banks in China. In addition, the investigation of loan management of banks will enable us to understand ways to prevent the formation of non-performing loans, namely the flow problem of non-performing loans.

[35] There are two reasons for the low proportion: 1) The capital market is under developed in China. 2) The policy forbids banks to invest money in stock market.

**Table 4.5 Asset structure of the four SOBs (In %)**

| **Bank** | | **90** | **91** | **92** | **93** | **94** | **95** | **96** | **97** | **98** | **99** | **00** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **ICBC** | Loan | 73 | 71 | 65 | 57 | 48 | 48 | 49 | 68 | 70 | 69 | 68 |
| | Securities | 1 | 1 | 1.3 | 1.2 | 2.3 | 2.8 | 3.1 | 4 | 8.5 | 9.2 | 10.1 |
| **ABC** | Loan | 68 | 67 | 63 | 62 | 46 | 56 | 61 | 64 | 69 | 70 | 72 |
| | Securities | 0.8 | 0.9 | 0.9 | 1.0 | 2.36 | 3.9 | 4.3 | 5.6 | 7.8 | 10.3 | 11 |
| **CCB** | Loan | 37 | 39 | 42 | 43 | 40 | 45 | 47 | 68 | 65 | 54 | 58 |
| | Securities | 0.4 | 0.9 | 1.8 | 1.7 | 3.4 | 4.5 | 4.8 | 5.5 | 5.79 | 8.8 | 9.7 |
| **BOC** | Loan | 39 | 37 | 35 | 35 | 47 | 48 | 50 | 51 | 52 | 51 | 50 |
| | Securities | 5.1 | 8.5 | 8.7 | 7.5 | 9.5 | 7.1 | 7.9 | 11 | 11 | 14 | 15 |

Source: Liu (1998), p.95.

Almanac of Finance & Banking on China (1998 – 2001)

**Table 4.6 Ratios of interest income to gross income in the four SOBs**

| Bank \ Year | 96 | 97 | 98 | 99 | 00 |
|---|---|---|---|---|---|
| ICBC | 0.74 | 0.77 | 0.83 | 0.88 | 0.86 |
| ABC | 0.96 | 0.99 | 0.97 | 0.99 | 0.98 |
| BOC | 0.74 | 0.75 | 0.77 | 0.90 | 0.90 |
| CCB | 0.77 | 0.78 | 0.82 | 0.95 | 0.95 |

Source: Almanac of Finance & Banking on China (1997 – 2001)

### 4.4.2 Functions of departments that manage credit & loans in two groups of banks

Appendix 4 lists the departments that are in charge of credit & loans in SOBs and shareholding banks. Before the organizational structure reform in Chinese banks was conducted in late 1990s', the organizational structures in Chinese banks were much hieratical and less market-oriented than they are now. Though there were a lot of departments in former organizational structure, the business departments were few and a bank couldn't catch the market trend in time. The departments shown in Appendix 4 are from the current organizational structure. As we may see from Appendix 4, except Guangdong Development Bank, SOBs and shareholding banks have separated the function of credit approval from credit marketing.[36] The Corporate Banking Department is the marketing department of a bank.[37] It is in charge of finding and choosing good quality customers for the bank. While the Credit & Loan Committee and Risk Management Committee are in charge of credit approval and credit review respectively. The Asset Protection Department is responsible for dealing with bad loans. The Private Banking Department and the Financial Institution Department are two departments that are in charge of credit business to individuals and inter financial institutions respectively.

Different from shareholding banks, SOBs divide their credit departments into more concrete departments according to different industries except BOC. ICBC has Industrial & Commercial Credit Department, the Project Finance Department and the Housing Finance Department to conduct credit business. Besides, the Corporate Banking Department., ABC has specially set up the Agriculture Loan Department and Real Estate Loan Department to provide loans to agriculture and real estate industries. CCB has established the Directive Committee for Small & Medium Enterprise Credit, the Real Estate Credit Department and the Special Credit Department. The division of credit business into several departments may be due to the fact that SOBs have large volume of credit business and they need to separate the credit management on the basis of industry. It is worth mentioning that CCB is the

[36] Before the reform, these two functions were centered in one department – credit & loan department.

[37] Bank of Communications empowers marketing department to do corporate banking.

first bank among SOBs to establish a committee for small & medium enterprise (SME) credit. Such measure should be deemed as the step towards commercialization of SOBs. The SOBs will not only choose SOEs as their customers, but give more loans to SMEs, part of which are non-state-owned enterprises and create considerable profits.

From the above comparison, we can see that organization structural reform has taken place in SOBs and shareholding banks. Both groups of banks have introduced more prudential practices to separate credit marketing and credit approval. The SOBs manage credit business in different industries in different credit management departments. CCB especially establish a committee for credit business of SMEs. Therefore, from the perspective of organization structure, SOBs and shareholding banks have much in common.

**4.4.3 Loan policies in both groups of banks and influence from government**

As we mentioned before, prices of "loans", interest rates are controlled by the PBOC and the interest rates must be within a set range. Therefore, competition between the two groups of banks is not by price of the loan but by the relationship with borrowing enterprises and government.[38]

What is the difference in loan policy between two groups of banks? In the

[38] If the bank has good relationship with local government, government will appoint profitable enterprise to borrow money from the bank.

following section the credit policy in SOBs will be reviewed before the reform is discussed.

Before reform, conventional commercial credits were regarded as oppositions to the planned economy and therefore forbidden. All domestic credit transactions were handled through PBOC. Branches of banks had no autonomy in granting credit, and they just extended loans according to plans set by the government. The deposits that that branches obtained were turned into PBOC without reserve. The credit plan was drawn up to allocate credit quota for each sector. There was no connection between the deposits that banks obtained and the loans banks could extend.

In 1981, the new credit management "Ca'er baogang" (Chinese Pinying) was enforced in the whole nation, it means that the bank that has met its deposit quota or credit task set by its headquarter could extend loans if it had extra deposits. In 1984, the reform of credit management stepped further to grant specialized banks more autonomy in utilizing its extra fund, when new management "Shidai shicun" came into effect. "Shidai shicun" means that a bank could utilize its extra fund at its disposal after providing the required reserve to the central bank. What's more the inter-bank loans were permitted. Under such credit management, PBOC set credit quota for each SOB so as to realize the monetary control. The credit quota plan not only restricts the quantity of loans that SOBs can provide, but also directs the use of funds.[39] Besides the interference from credit policy, Wong and Wong (2001) argue that banks are still under the pressure from government in the form of senior bank appointments as we have discussed earlier in this chapter.

The shareholding banks are not subject to such direct credit management interference from the government. They should only abide by the loan to deposit ratio set in the Commercial Banking Law.[40] Under such a policy, they can choose their customers freely and extend loans according to borrowers' capability and follow the principle of "pursuing the maximized profits".

From the above comparison, we can conclude that the credit & loan management in shareholding banks is more market-oriented and commercialized in the following ways:

a) Flexible credit control. Before 1998, SOBs should rigidly abide by credit quota plan set by PBOC while shareholding banks should only follow the specific ratio requirement specified in the Commercial Banking Law.
b) Less interference from government. Shareholding banks have more flexibility to find its borrowing customers. Unlike SOBs, which are restricted on the use of funds and face great interference from the government These two advantages have brought more independence for shareholding banks in their credit

[39] The credit quota plan was abolished in 1998.

[40] The ratio is 75% according to commercial banking law, which means that only 75% deposits can be used to extend loans for the sake of safety.

management and enable them to manage credit on the principle of maximizing profits. Therefore, shareholding banks have less NPLs and have better performance than SOBs.

However, shareholding banks also have their disadvantages in terms of policy support. Wong and Wong (2001) argue that shareholding banks' ability to extend loans is limited by their fundraising ability and loan services they are permitted to provide. Currently, commercial banks in China are not allowed to issue bonds and only three banks have their stocks listed on the stock market. For loans from PBOC, Wong and Wong (2001) further point out that PBOC only extends a small portion of its loans to shareholding banks. Table 4.7 shows that the PBOC's loan to shareholding banks accounted for less than 1 percent of its outstanding loan from 1994 to 1998.

**Table 4.7 Loans from PBOC to Commercial Banks**

| **Loans from PBOC to Shareholding Banks (100 Million RMB)** | | | | | |
|---|---|---|---|---|---|
| | 1994 | 1995 | 1996 | 1997 | 1998 |
| **SOBs** | 10,182.2 | 11,095.2 | 14,088.5 | 13,885.1 | 11,867.2 |
| **Shareholding Banks** | 92.6 | 43.7 | 81.2 | 59.7 | 77.8 |
| **Share of other shareholding banks (%)** | 0.9 | 0.39 | 0.57 | 0.43 | 0.65 |

Source: Wong and Wong (2001), p.31.

### 4.4.4 Loan procedure in two groups of banks

From our interviews, we found that both shareholding banks and SOBs have established a similar process for credit management including application, investigation before approval, examination by customer managers, approval and credit review. In the following part, we will describe the process in general.

*Application and investigation of information of borrowing enterprises*
First, the borrower will submit an application to the Corporate Finance Department of the lending bank. As we have mentioned earlier, the Corporate Finance Department acts as marketing department to find good quality borrowers in the market. The customer managers of the Corporate Finance Department will then report the case to their head.

In order to obtain basic information about a borrower such as background of the enterprise, operation scale, business scope, market share, and the intended use of the loan, the customer managers together with their head will pay an on-site visit to the borrowing enterprise and talk with senior management of the borrowing enterprise in general and the chief financial officer in particular. The purpose of the on-site visit is to verify the situation of the borrowing enterprise. In addition, in this stage, the borrowing enterprise is required to provide historical and current financial reports, proposal for the use of loan, and legal documents such as operation license. If the loan is a guaranteed one, the required documents on the guarantor must be attached.

*Examination by customer managers*

First, based on the financial reports provided by the borrowing enterprise, the customer manager calculates the required financial ratios[41] according to an evaluation system of the bank. The credit evaluation system is designed to appraise the borrowing enterprise's liquidity, profitability and business prospect. The system will produce an overall score to indicate the credit status of the enterprise and estimate the risk of the loan. Some banks use automatic credit evaluation system – the customer manager only needs to input the financial ratios into computer and the computer will give the final score of the borrowing enterprise automatically. Other banks require the customer manager to calculate the final score by themselves following their banks' calculation models.[42] But in either case, the financial ratios are used to generate the final overall score. If the applicant doesn't get a passing score (usually the passing score is 60), the customer officers will reject the application.

Second, the customer manager will prepare a credit report on the basis of financial reports and other documents the applicant produces. An example of a credit report can be found in Appendix 3.[43] Though the constituents of the credit report may vary from bank to bank, the major components are almost the same. The report

[41] The financial ratios include the liquidity, profitability, and other items.

[42] Interviewees deemed the calculation model as a commercial secret and were not willing to disclose it.

[43] For the sake of interviewee, we won't disclose which bank the report comes from.

consists of 7 parts. 1) The background of borrowing enterprise. The background include information such as the location, legal person representative, year of establishment, paid-up capital, and business scope etc. 2) The quality of the borrowing enterprise. The quality includes the quality of managers, employees and the enterprise's competitiveness. 3) This part is the most crucial part and is divided into two sections. In the first section, the customer manager analyzes asset quality and financial status of the enterprise. In detail, the customer manager would analyze the borrowing enterprise's operation scale, ability to pay back loans and its credit record. Also the analysis on assets and liabilities and big projects will be conducted. In the second section, the customer manager will evaluate the management and performance of the borrowing enterprise. The emphasis is put on the enterprise's strategy, internal management, sources of income and future development direction. 4) The purpose and the use of the loan. 5) Analysis of the guarantor or collateral. 6) Business transactions in the bank that the applicant wishes to borrow the loan from. 7) In this part, the customer manager will give its decisions and recommendations. This procedure serves to form an initial judgment of the borrowing enterprise and provides quantitative and qualitative information to the Credit and Loan Committee.

*Approval by credit & loan committee*

When the customer manager has completed the initial examination, he will pass the report to the Loan Committee, which is a department responsible for examining and approving loans. The Committee comprises of personnel with rich experience in this area. They make further analysis and examination on the basis of reports presented by the customer manager. If the Loan Committee finds doubtful points or omissions of information, it will ask for clarification from the Customer Manager.

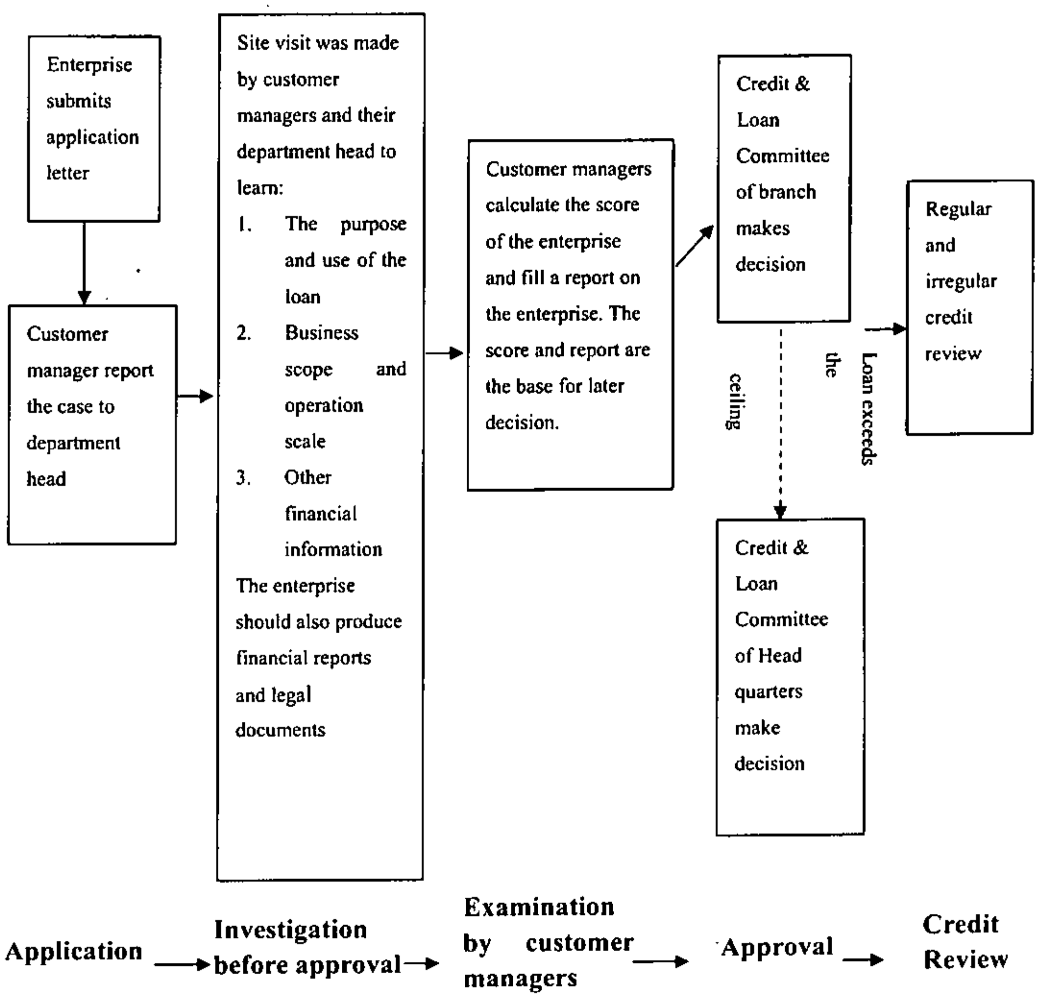
Next, the Loan Committee will hold a meeting to make the decision. The participants of the meeting include department head in charge of credit, members of the Loan Committee, president of the branch office and customer managers. In the meeting, discussion will center on the use of the loan and borrowing enterprise's ability to repay loans. The committee will make final decision on whether to lend the loan and the terms of the loan. We were told that if the loan exceeds the ceiling that the Credit & Loan Committee of the branch has power to approve, the loan application should be reported to the Credit & Loan Committee of headquarter for approval.

*Credit review*

After extending the loan, the customer managers and the president of the branch office will pay regular visits to the borrower.[44] In each visit, the customer managers will collect financial statements, check enterprise's operation conditions and the use of the loan. After each visit, the customer manager should draft a report. Asides from regular visits, the customer managers and department head will investigate the borrowing enterprise anytime they like. Chart 4.5 summarizes the procedures of lending in Chinese banks.

[44] The visit will be conducted monthly, quarterly, half-yearly and yearly.

**Chart 4.5 Procedure of lending**



From our interviews on bank managers, currently all loans in Chinese banks must be guaranteed or hypothecated and the choice of interest rate on loans should be within the range set by PBOC.[45] Both SOBs and shareholding banks can negotiate with borrower to set an appropriate interest rate within this range.

Though both groups of banks adopt similar procedures of lending, there were much differences in the execution of the procedures. 1) For SOBs, when levels of government indirectly interfere with the loan business, SOBs should follow government's will to extend loans even the borrowing enterprises cannot meet the banks' basic lending criteria. In this aspect, the shareholding banks more rigidly follow their lending requirements and certainly choose customers of better quality. The different flexibility of choosing customers has led to different quality of loans and thus led to different performance between the two groups of banks. 2) Besides the interference from government, the quality of employees in charge of loan business differs. A manager from China Minsheng Bank pointed out that they especially employ famous lawyers, and experts in some important industries (IT and steel and etc.) to be members of their Credit & Loan Committee. These experts will help the committee to make better loan decisions. While in SOBs, the members in such committee may not necessarily have expertise and usually follow a formality to

[45] In 1998, PBOC substituted loan quota control over the Big 4 with interest rate control. The banks have been allowed to offer loan in the range of 20% above to 10% below official lending rates.

arrive at their decisions.[46] More specialists in credit & loan committee of shareholding banks have resulted in more correct decisions than in SOBs. The specialized knowledge and vision of industry brought by experts have prevented the potential NPLs from increasing, thus greatly lowers credit risk. 3) More corruptions and fraud cases in SOBs than in shareholding banks. The recent Bank of China's case[47] shows that unlawful loans and even fraud loans were used as a channel to divert money from banks to individuals. It is proposed by a Chinese banking expert that every SOB in China has problems as that, and it is the product of the system – the politics and connections overwhelming the commercial behavior. The corruption and fraud cases have brought big loss to Bank of China and led to the dismissal of the former President – Mr. Wang Xuebin. If the system doesn't change, such problems won't decrease and SOBs will continue to make loss.

In sum, government interference plays an important role in credit management in SOBs. Because of it, it is more difficult for SOBs to reduce NPLs and improve bank performance. From the comparisons we have made in this chapter, though the shareholding banks have their own disadvantages, they have significant merits and strengths resulted from shareholding entities. They have more effective corporate governance to reduce agency cost, flexible personnel management and incentive

---

[46] An interview pointed out that sometimes the borrower had already been assured of getting the loan even before the credit & loan committee held the meeting and made final decision. Therefore, such meeting is just a formality.

[47] According to the Rosenthal (2002), $320 million of bank funds had been diverted from several branches of Bank of China through "unlawful loans, off-the-books business and the unlawful granting of letters of credit and issuing bank bills.

mechanism, and less interference from government in their lending decisions.

## *4.5 Conclusion*

This chapter examines the management and performance of the SOBs and shareholding banks from organizational and managerial perspectives. First, the investigation of corporate governance proves that with inter-disciplined shareholding mechanism, shareholding banks are more commercialized and less influenced from government. However, since most controlling shareholders are from government, the effectiveness of shareholding corporate governance remains limited. Second, the flexible and market-oriented personnel management and incentive mechanism in shareholding banks are the factors that the SOBs do not possess when competing with shareholding banks. Last, the examination of credit management shows that the procedures of lending in both types of banks are similar, however the less interference from government and less corruption have contributed to the better quality of loans in shareholding banks.

# Chapter 5 Policy implications and recommendations

## *5.1 Introduction*

The previous chapters explored the external and internal factors that influence the performance of SOBs and shareholding banks, using an institutional approach. In this chapter, all these factors will first be reviewed, in the light of the analyses and findings of chapters 3 and 4. It follows that policy actions taken by the government and commercial banks respectively in recent years can be better understood and justified. Based on these, we will also try to make some recommendations in regard to the future development of the Chinese banking sector.

## *5.2 Review of factors explaining the differential performance*

The impacts of the various factors on the performance are summarized in Table 5.1. It can be seen that the relatively poor performance of the SOBs can be attributed to the negative impacts of the legacy problem, corporate governance, personnel policy, and ineffective enforcement of the credit management measures. However, the difference in performance between the two groups of banks must also be judged against the negative impact of the legal and policy environment, and small positive impact of corporate governance for shareholding commercial banks.

On the basis of these findings, the policy implications appear to be obvious. The government has sought to minimize the negative impacts of the factors, and build up the institutional factors that have positive effects on performance. The author will first justify the recent reform measures adopted in the Chinese banking industry.

**Table 5.1 Summary of the influence of factors on the performance of two types of groups**

<table>
<tr><th colspan="2">Factors</th><th>Four SOBs</th><th>Shareholding commercial banks</th></tr>
<tr><td rowspan="2">External factor</td><td>Legacy problem</td><td>Negative</td><td>Not applicable</td></tr>
<tr><td>Legal and policy environment</td><td>Positive</td><td>Negative</td></tr>
<tr><td colspan="4"></td></tr>
<tr><td rowspan="4">Internal factor</td><td>Corporate governance</td><td>Negative</td><td>Positive but small</td></tr>
<tr><td>Personnel policy</td><td>Negative</td><td>Positive in junior personnel management. But negative in senior appointment.</td></tr>
<tr><td rowspan="2">Credit management</td><td colspan="2">Similar credit management system in place. Assets are concentrated in loans due to separation of businesses amongst banks, securities and insurance</td></tr>
<tr><td>Ineffective enforcement due to more direct government interference; corruptions and frauds</td><td>Such cases are little heard in shareholding banks</td></tr>
</table>

## *5.3 Justifications for government policies*

### 5.3.1 Enhanced supervisory role of PBOC

PBOC was formally named as the central bank in 1984. However, PBOC' role was not legally endorsed until the PBOC law was passed in 1995. The law, however, fails to give independence to the PBOC: PBOC is under the leadership of the State

Council and its senior staff is appointed by government. The role of the PBOC now mainly focuses on the approval of banks' market entry, banks' scope of business and new products while the supervisory role in regard to the banks' credit risks has not been effectively carried out. Furthermore, some of the regulations have not been elaborated on the implementation details and the permissible activities of banks are not clearly defined. This will have negative impacts on the innovations of bank products and banks' capability to manage credit risks.

*The restructuring of PBOC*

Before 1998, the branches of PBOC were still established according to administrative regions instead of economic regions, levels of governments could exert influence on PBOC and it was hard for PBOC branches to reconcile the different economic needs of central and local government. [48] Against such background, nine first-tier branches were established to replace the 31 main branches in provinces (along the lines of the US Federal Reserve System) from 18 November 1998.[49] The nine regional branches are established in Tianjin, Shenyang, Shanghai, Nanjing, Jinan, Wuhan, Guangzhou, Chengdu, and Xian. Appointment of key staff

[48] Lee (2000) points out that the intervention of local governments comes from the economic system in China: local governments are responsible for organizing and managing the local economy. In order to create excellent political performance – the growth scale of the economy, officials usually directly or indirectly intervene PBOC so as to raise the capital they need. Such orders are usually conflicting with macro-economic plan in central government.

[49] In US Federal Reserve System, the nation has been divided into twelve Federal Reserve Districts, with Federal Reserve Banks in Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, Kansas City, Dallas, and San Francisco. Twenty-five Branches of these Banks serve particular areas within each District.

for the regional branches is now made by the head office of the PBOC, minimizing the influence of the provincial government over the operations of the PBOC.

*Market-based tools*

PBOC once used direct tools such as credit quota plan as monetary policy instruments. However, such tools were considered as not being good to market competition and SOBs' transformation to commercial banks. In January 1998, PBOC substituted loan quota control over the four SOBs with interest rate control. The banks have been allowed to offer loans in the range of 20% above to 10% below official lending rates. The great change brings banks more freedom in lending, while government can only affect the activities of banks indirectly through the state plan, industrial policies and interest rate variations. This demonstrates that the PBOC has taken the monetary instrument from directive order into market-oriented method such as interest rate, open-market operation and asset-liability management.

### 5.3.2. Reduction of the NPL

*Establishment of policy banks*

To prevent the formation of new NPLs and free SOBs from social obligations, in 1994 government established 3 policy banks to separate policy business from SOBs.[50] The three policy banks -- State Development Bank of China, the Export-Import Bank of China, and the Agricultural Development Bank of China –

[50] Please refer to Chapter 2 for the information of the establishment of three policy banks.

serve to replace four SOBs to provide policy loans to the construction of infrastructure, basic industries and pillar industries, foreign trade business (especially to promote the export), and agricultural areas.

*Establishment of asset management companies*

Besides separating policy loans from SOBs, Chinese government has taken action in dealing with the existing NPLs in four SOBs. In this regard, the Chinese government has established four asset management companies – China Xinda Asset Management Corporation, China Orient Asset Management Corporation, China Great Wall Asset Management Corporation and China Huarong Asset Management Corporation in 1999. Table 5.2 shows the date of establishment and the amount of paid-up capital of the four asset management companies, which are to take over NPLs from CCB, BOC, ABC and ICBC respectively.

**Table 5.2 Start-up information about four asset management companies**

| Name | Date of Establishment | SOB[51] | Paid-in Capital |
|---|---|---|---|
| **China Xinda Asset Management Corporation** | April 20, 1999 | CCB | RMB 10 billion |
| **China Orient Asset Management Corporation** | October 15, 1999 | BOC | RMB 6 billion and USD 0.5 billion |
| **China Great Wall Asset Management Corporation** | October 18, 1999 | ABC | RMB 10 billion |
| **China Huarong Asset Management Corporation** | October 19, 1999 | ICBC | RMB 10 billion |

[51] SOB from which the AMC is responsible for taking over the non-performing assets.

The major scope of the four asset management companies is through the purchase and management of the non-performing assets transferred from corresponding SOBs. These can involve the swapping, transferring and selling of assets; the debt-equity swap; the recommendation for listing and underwriting bonds; refinancing from the Peoples Bank of China.[52] The four asset management companies are under the joint supervision of the PBOC, CSRC and MOF in their banking, securities and financial activities.

By June 2001 the four asset management companies had purchased the non-performing assets totaling 1,393.9 billion RMB. These include 407.7 billion from China Huarong, 345.8 billion from China Great Wall, 267.4 billion from China Orient and 373 billion from China Xinda.[53]

### 5.3.3. Financial and governance structure of banks

*Capital structure of banks*

The government has also made efforts to improve the capital structure of SOBs. In 1998, MOF issued 270 RMB billion special government bonds to recapitalize the SOBs. Such action sharply increases the capital/assets ratio for SOBs as shown in Table 5.3.

52 Orient Asset Management Corporation website: www.coamc.com.cn

53 Anonymous, 2001. "Four Asset Management Companies."

**Table 5.3 Assets and capital of the SOBs (RMB billion yuan)**

| | 1997 | | | 1998 | | |
|---|---|---|---|---|---|---|
| | **A = Total assets** | **B = Equity capital** | **B/A (percentage)** | **A = Total assets** | **B = Equity capital** | **B/A (percentage)** |
| ICBC | 2937.8 | 96.9 | 3.30 | 3238.7 | 183.9 | 5.68 |
| **ABC** | 1573.9 | 39.8 | 2.53 | 2022.4 | 134.8 | 6.67 |
| **CBC** | 1681.8 | 49.6 | 2.95 | 1923.6 | 100.5 | 5.22 |
| **BOC** | 2231.7 | 87.7 | 3.93 | 2475.4 | 139.6 | 5.64 |

Source: China Finance Society 1999, pp 427-29.

*Transformation of SOBs into shareholding banks*

A shareholding structure in contrast to 100% state ownership of the SOBs can bring in benefits of more effective corporate governance, flexible personnel management and incentive mechanism, and less interference from government.

There has been suggestion that the SOBs should be transformed into shareholding entities with participation by non-state institutional investors. It is also suggested that SOBs should go public to achieve a better monitoring over the performance of state banks.

In fact, government has expressed its idea of conducting shareholding reform in SOBs and corporate governance becomes a concern for policy makers. In September

2001, Mr. Dai, the governor of PBOC, pointed out that government will spend about five years to transform the four SOBs into modern big commercial banks with comparable competitiveness in international financial markets. And shareholding reform and going listed are two key channels to realize the goal.[54]

### 5.3.4. Improved implementation of credit management

*The Commercial Bank Law*

The examination of credit policy and credit management in the two groups of banks discloses that interference from government still plays a vital role in banks' credit management. The lack of independence in making credit decision, corruption and fraud cases have hampered an effective credit management in SOBs.

The Commercial Bank Law passed in 1995 is aimed at ensuring banks' independence and providing guidelines for banks to manage risk. The law confirms the independent role of commercial banks and specifies means for banks to manage risk by financial ratios, including deposit reserves, liquidity and capital adequacy ratios.

Every commercial bank must place a deposit reserve with the central bank and keep adequate standby reserve in accordance with the stipulations of the PBOC. Article 39 provides:

[54] Anonymous, 2001. "The Inevitable Trend for Shareholding Reform of State-Owned Banks."

1) The capital adequacy ratio must not be lower than 8%;

2) The ratio of the outstanding balance of loans to deposits must not exceed 75%;

3) The ratio of current assets to current liabilities must not be lower than 25%; and

4) The balance of loans to one borrower must not exceed 10% of the capital of the bank.

The Commercial Bank Law also contains specific requirements on the conduct of bank staff and stipulates legal liabilities for failure in carrying out their duties. Article 52 stipulates that staff of commercial banks must abide by the law, administrative regulations, and other relevant regulations and rules. The following conducts stipulated in Article 52 are prohibited:

1) Taking advantage of their positions to demand or accept rights, or accept commissions or service fees under any pretext;
2) Taking advantage of their positions to commit graft, misappropriation or unlawful possession of the funds of any bank;
3) Providing loans or guarantee to relatives or friends in violation of regulations;
4) Holding positions concurrently in other economic institutions; and
5) Other acts in violation of the law, administrative regulations and rules in business management.

*Risk-based loan classification system*

The Chinese government has replaced the old loan classification (based on the sduration of overdue period) with five-category loan classification method (based on risk). Under the new method, loans are classified as Pass, Special Mention, Substandard, Doubtful and Loss.[55] This classification aims to assess the real value and risk of loans and reflect credit quality in a more reliable, comprehensive and dynamic manner. It also serves to provide the basis for assessing adequacy of loan loss provision.

*Accounting information*

As mentioned in chapter 3, the overall quality of information provided by banks in China is below international standards. To ensure the independence of accounting and auditing firms, State Council required that they be restructured and disengaged from the administrative departments before the end of December 1998. In May 2001, CSRC and MOF claimed to grant Big 5 auditing firms the authority to audit listed financial institutions in China.[56] This policy shows that the authorities have attached

[55]Pass: borrowers can honor the terms of the contracts, and there is no reason to doubt their ability to repay principal and interest of loans in full and on a timely basis.

Special-mention: borrowers are still able to service the loans currently, although the repayment of loans might be adversely affected by some factors.

Substandard: borrowers' ability to service loans is apparently in question, cannot depend on their nor mal business revenues to pay back the principal and interest of loans and certain losses might incur even when guarantees are executed.

Doubtful: borrowers cannot pay back principal and interest of loans in full and significant losses will incur even when guarantees are executed.

Loss: principal and interest of loans cannot be recovered or only a small portion can be recovered after taking all possible measures and resorting to necessary legal procedures.

PBOC website: http://www.pbc.gov.cn/english/news/show.asp?b=23

[56] Big 5 accountant firms refer to top 5 accountant firms in the world: Arthur Anderson, Deloitt, KPMG, Earnest & Young, and PriceWaterhouseCoopers. Source: Huaxia Dadi Distance learning services website: http://www.edu-edu.com.cn/hx_new/kuaiji/shidian/hysd20011101 5.html

great attention to the reliability and transparency of accounting and auditing statements in financial companies. As a result, more and more banks in China have adopted international standards in their financial statements and employ top 5 accountant firms in the world to audit their accounts.[57]

## *5.4 Justifications for SOB's business policy*

*Reducing costs of SOBs*

SOBs have been shown to be burdened with redundant employees and branches. This burden inevitably incurs huge cost for the SOBs and creates a disadvantage for SOBs when competing with shareholding banks.

The SOBs have taken some measures to cut down the size of staff and streamline and rationalize organizational structure. The state-owned commercial banks have consolidated local branches, merged provincial branches with municipal branches of the provincial capitals, and closed offices at the area level with overlapped business or chronic losses in 1999.

All the four SOBs are expected to cut down 20% to 30% of their employees. For example, there are about 500,000 employees in ICBC and the action will decrease

[57] The international accountant firms acting for Minsheng Bank, China Everbright Bank and China Merchants Bank are Price Waterhouse Coopers, Arthur Anderson, KPMG respectively.

the number of employees by 100,000 to 150,000.[58] Actually, by the end of 2000, ICBC laid off 75,000 employees and there are plans to reduce 30,000 more people in 2002. BOC also laid off 12,000 employees and closed 229 branches in the past two years – 2000 to 2001.

*Credit scoring system*

The system is set up for banks to share the credit records of enterprise and individual customers. Many regions in China including Shanghai, Guangzhou and Wuhan have explored to set up credit services companies. The most noticeable one was the establishment of the Credit Information Services in April 2001 in Shanghai to provide customers' credit information for banks. This will help to reduce the credit risks of banks.

*Audit and accountability system of SOBs*

The four SOBs strengthened the internal control system by launching internal supervisory committees to oversee loan decisions. At the same time, they introduce accountability system by rewarding loan officers and bank executives for good financial performance and penalizing failures. In addition, the government has shown its determination to make the SOBs be accountable for their own credit decisions and stop making any policy loans.

[58] Anonymous, 2001. "The Downsizing of Employees in Banks: A Silent Revolution."

The above analyses show that both Chinese government and SOBs have adopted a lot of measures to reform the banking industry and to improve bank management. The enactment and implementation of these regulations have helped to improve the soundness and stability of the Chinese banking industry. In the next section, the author will make recommendations for the future development of Chinese banking industry on the basis of the findings in proceeding chapters.

## *5.5 Recommendations for further banking reform in China*

### 5.5.1 Policy recommendations for government

*Level playing ground*

The analyses have shown that the SOBs and shareholding banks are not playing on the level playing ground. First, the monopoly role of SOBs and government's back up have forced shareholding banks to only compete in a very minor market share and is not good to foster a competitive environment. Second, government has lent a lot of support to solve the NPLs problem in SOBs. Third, in terms of business scope, PBOC grants more privilege for SOBs to provide new products and services.

In this context, the recommendations for government are that: First, effective measure should be adopted to help shareholding banks to write off bad loans. If government ignores this issue, the NPLs in shareholding banks will form a big threat to Chinese banking industry as NPLs in SOBs do.[59] The situation would be worse when Chinese banking industry fully open to foreign banks. At that time, shareholding banks cannot rival foreign counterparts since their financial condition is though better than SOBs are not sound compared with foreign banks. Second, government should not grant any privilege to either group of banks in aspects of providing new banking products and service. Instead, PBOC should state clearly the requirements for each new products and service. As long as banks meet these requirements, they should be allowed to do such business. Only by doing this, banks have more impetus to innovate banking products and improve services and correspondingly foster a fair competition environment.

*Increased scope of non-banking business*

After the accession to WTO, Chinese banks will meet challenges from foreign financial institutions whose parent group usually operate commercial banking, insurance and securities business as well. The separation of banking, insurance and securities business in China has gradually become a major obstacle to enhancing the competitiveness of Chinese banks, which should be abolished in the long run. In fact, since 1980s Australia, New Zealand, Britain, Canada, Japan and USA have lifted the restrictions on cross-lapping business respectively. Some co-operations amongst

[59] Some managers from shareholding banks pointed out that though the scale of NPLs in shareholding is not as large as it is in SOBs, it is a potential problem if we consider the history of shareholding banks which is much shorter than that of SOBs. Therefore, government's help of dealing with NPLs in shareholding banks should be lent before problem comes out. However, how to lend governmental help so as to prevent "moral hazard" remains a hot topic and will not be elaborated in the thesis.

banks, insurance and securities have been noticed in China. Branches of banks can now collect premiums for insurance companies, and act as agent for securities companies in opening stock accounts for clients. Some mergers amongst banks, securities firms have also taken place.[60] The PBOC should continue these policy efforts.

*Market-based personnel policy and incentive mechanism*

Both SOBs and shareholding banks are now interfered in their personnel management by local governments. Commercial banks still have to follow government's will to arrange senior management and the SOBs still adopt the bureaucratic personnel management (even the title for each management level follows the government hierarchy). Such personnel management and inflexible incentive mechanism have led to the loss of talents in SOBs. The situation will worsen after China entered WTO since foreign banks will expand their business in China by employing local talents familiar with Chinese environment. They will offer better rewards and better work conditions than Chinese banks do.

SOBs should abolish the administratively based personnel management and a

[60] Shenyin Wanguo security company (Top 5 security company in China) has joined in Everbright Group and provided the group with high-quality asset, securities resources and capital operation experiences. It has paved the way for Everbright Group to develop into a competent financial group in the world. ICBC, through merger, reorganization and investment, has set up investment banks and merchants' banking institution. China International Trust & Investment Corp. also has taken steps to accelerate the steps of doing mixed business: besides CITIC Industrial Bank, it has established CITIC Securities Company through reorganization.

market-based incentive mechanism must be developed. Government should let banks choose their own managers from the market, and pay them with the market rate. More training programs should be provided for their employees so as to increase their productivity.

### 5.5.2 Policy recommendations for banks

According to the agreement reached concerning China's accession to WTO, China makes its commitment to full market open in five years for foreign banks. Foreign banks will be able to conduct local currency business with Chinese enterprises starting 2 years after entry. Foreign banks will be able to conduct RMB business for Chinese individuals 5 years after accession. By that time, foreign banks will enjoy the national treatment and geographic restrictions will be removed in five years. The entry of WTO brings both opportunities and challenges to Chinese banks, as they should prepare for an onslaught of competition from global financial institutions with much stronger management, financial resources and technology. Although it is not until 2005 that China's banking sector will open fully to foreign banks, both foreign and Chinese banks in China are already engaging themselves in preparation for the incoming keen competition. In the following part, we will provide recommendations as to what actions should Chinese banks take to meet challenges brought by entry of WTO.

*Strengthening capital base and monitoring*

Both SOBs and shareholding banks should strengthen their capital base. By going public, shareholding banks can raise more capital and expand their assets. Whilst both types of banks can be better monitored in their performance by the market, shareholding banks gradually break up the monopoly role of SOBs. Currently, there are four listed banks in China's A share market -- Shenzhen Developed Bank, Shanghai Pudong Development Bank, China Minsheng Bank and China Merchants Bank.

*Consumer banking products*

Currently the business scope of Chinese banks still concentrates on deposit taking and credit lending (mainly to enterprises) only, leaving other banking businesses underdeveloped. Meanwhile, foreign banks have accumulated rich knowledge and developed well in consumer banking business, using advance technology. Therefore, before the entry of foreign banks in the domestic currency market under the WTO agreements, Chinese banks should actively promote the consumer products and enhance their technological capability.

The consumer banking businesses such as credit card, mortgage credit and other consumer credit for education, cars, durable goods, traveling is still in infant stage in

China.[61] The potential for consumer banking business is enormous given the huge size of China's population and the high growth rate in the country's economy. Chinese banks therefore, should exert more efforts in developing financial products, especially provide specific services that tailor the needs of individual customers.

Chinese banks will not only have to be more responsive to meet their customers' needs, they will also have to be more efficient in delivering their services with the application of technology. E-banking in China should be greatly improved in order to better compete with foreign banks in future.

*Foreign partnership*

Chinese banks can also enhance their competitiveness by seeking partnership with foreign banks. The partnership with foreign banks will force Chinese banks to align themselves with international practices and improve the operating transparency. Chinese banks can increase their capital base and improve their risk management with the presence of foreign partners. All these will help Chinese banks to integrate into the world banking market.

Recently such attempts have begun in some small and medium sized banks. At the end of 2001, HSBC and International Finance Corporation injected capital into Bank of Shanghai. The alliance established between foreign and Chinese banks should be

[61] They accounted for less than 1% of total outstanding loans of the banking system at the end of 1998.

advocated. This is a vital channel through which Chinese banks can realize internationalization and enhance competitiveness in post-WTO period.

## *5.6 Conclusion*

Based on the summary of factors explaining the difference in banks' performance, Chapter 5 justifies the policy actions taken by the government, which include enhancing the supervisory role of the PBOC, setting up of asset management companies and policy banks to prevent the formation and reduction of NPLs in the four SOBs, and improving the financial and governance structure of banks and their credit management. It is also justified that for the shareholding banks to cut costs by reducing number of employees and branches, set up credit scoring systems, and improve audit and accountability systems. On the basis of such justification, several recommendations are also given in Chapter 5. For government, it should help shareholding banks to write off bad loans, the PBOC should broaden the business scope of non-banking business to commercial banks, and encourage the sadoption of market-based personnel policy and incentive mechanism in SOBs. For SOBs and shareholding banks, they should strengthen their capital base, promote their consumer products, and seek partnerships with foreign banks.

# Chapter 6 Conclusion

## *6.1 Introduction*

This chapter first provides a conclusion of the whole thesis. Then we will point out the limitations of quantitative and qualitative methods employed in the thesis respectively. The last section goes to the possible future research about Chinese banks.

## *6.2 Conclusions of the study*

The system of Chinese banking sector has been changing greatly along with the transition of planned economy into market economy. Since the 1978 reform, the mono-bank system has been broken up and diversified in structure in phases. The four SOBs were separated from PBOC and are being transformed into commercial banks. The three policy banks have been established to take over the policy business from SOBs; 10 shareholding banks were set up and 90 credit cooperatives were turned into city commercial banks; banking market has gradually opened to foreign banks and the market will completely open in five years from China's entry into WTO. In the same period, the supervisory and legal framework have been established and improved. In 1984, the central banking system was established and PBOC was legally granted its independence role in 1995.

Despite the progress made in the Chinese banking industry, some problems still remain unresolved. First, the SOBs still dominate banking system in terms of assets, capital, loans, deposits or branch network. As a result, though shareholding banks, commercial banks and foreign banks were either set up or introduced into Chinese banking market, a real competitive environment has not been fostered. Second, Chinese banking system suffers from the following weaknesses: redundant employees and branches in SOBs, high stock of NPLs that leads to the low capital asset ratios in SOBs and interest rate controls. These weaknesses have added risk and fragility to Chinese banking system and should be put on the list of government's agenda. Third, PBOC as the independent central bank with its role legally established in 1995 was still interfered by government and has a long way to go before becoming a truly effective supervisory body.

The quantitative and qualitative analyses in Chapter 3 and Chapter 4, which compare the performance between two groups of banks – the SOBs and shareholding banks, provide support that shareholding banks perform better than SOBs. The results are however derived from the interplay of various institutional forces, exhibited in internal and external factors.

First, burdened with the large number of NPLs inherited by historical legacy, SOBs have poor capital asset ratios and are not able to perform as well as shareholding banks. However, the determination of the government to improve the performance of four SOBs has led to the fact that SOBs enjoy various preferential treatments from the government.

Second, shareholding banks have a better corporate governance, market-oriented personnel management and incentive mechanism. With savings in monitoring and agency costs, shareholding banks perform better than SOBs.

Third, both types of banks have employed similar credit management procedures. However, because of governmental interference and more corruption and fraud cases in SOBs, they tend to have more unqualified loans than shareholding banks do. This may be another reason to account for the better performance of shareholding banks.

The recent policies and measures that both government and banks took have well addressed the existing problems in Chinese banking industry.

In terms of governmental actions, the Chinese government has made moves to deal with the big stock of NPLs by setting up asset management companies and prevent the flow of NPLs by shifting policy business to policy banks, financial restructuring SOBs and introducing international standards to manage loans and risk in banks. To establish effective corporate governance for SOBs, Chinese government encourages them to conduct shareholding reform and have plans for listing the SOBs. The promulgation of Commercial Banking Law provides guidelines for Chinese banks to manage credit risk. Furthermore, PBOC embarked on improving its bank supervision more effectively and market-oriented by reorganizing braches based on economic principles and changing the supervision tool from direct means to indirect means.

At the bank level, the four SOBs have started to downsize their employees and branches. The merger of provincial branches with municipal branches has been done in all four SOBs and it is anticipated that in future the four SOBs will cut down their employees by 20% to 30%. In addition, in response to the corruption and fraud cases in credit management, banks have introduced accountability system to better prevent those cases from taking place.

China's accession to WTO will bring Chinese banking industry both opportunities and challenges. It needs further reforms before fully opening to foreign counterparts. Therefore, our recommendations are:

For the government, it should provide level playing ground for both the four SOBs and ten shareholding banks – to eliminate the four SOBs' social obligation and allow room for further development of shareholding banks. The government should allow banks to engage in other sectors of business -- insurance and securities gradually, which can diversify banks' asset structure and bring more profitable opportunities. Last but not the least, government should loosen their control over banking industry. More flexible personnel management and more market-oriented incentive mechanism should be advocated.

For banks, to meet the challenges brought by foreign banks and boost their competitiveness, we recommend that banks explore and develop consumer banking markets with the application of technology since these services are profitable. Hopefully, the Chinese banks can well establish their market niche before the full competition from foreign banks. Lastly, establishment of partnership with foreign counterparts should be advocated as a "win-win" measures for Chinese banks and foreign banks. The foreign banks, which are financially strong, managerially advanced, technologically leading and globally established, can enhance Chinese banks by injecting capitals, standardizing Chinese banks' management and strengthening their role in global markets. While through the allegiance with Chinese banks, foreign banks can make use of Chinese banks' comprehensive network, familiarity with local policies and markets, good relationship with local clients and government.

## *6.3 Limitations*

Though this study raises some interesting issues based on the analyses, it is subject to several limitations that might affect the validity of research results, as it is so often the case in research on Chinese banking industry.

The first limitation concerns about the unavailability and incomplete data we employed in the quantitative analyses. As we know, China has a limited number of banks -- only four SOBs and ten shareholding banks. Since it was not until 1993 that all shareholding banks established and released their financial data to public, we have to study bank performance beginning from 1993 and thus seven years' data were employed. The fact that too few data were used is inevitable in China where all banks have a short history compared with those in western economies. Hopefully, this limitation will be eliminated in the future when more banks are allowed to operate business and banks have longer history to provide more data.

The second limitation goes to the inconsistency of the data that Chinese banks provide. All of data we used in regression model were secondary data and they are either from Almanac of China's Finance and Banking or websites of the banks. The data are inconsistent in two aspects: 1) they are inconsistent among different banks. 2) they are inconsistent along different years. Currently all banks are required to implement "The law of Accounting in the People's Republic of China". This law only sets out basic accounting principles and not effective in unifying the accounting standards. Besides the accounting law, SOBs and shareholding banks adopted different accounting systems. SOBs apply "The Accounting System for Financial and Insurance Companies"; while shareholding banks apply "The Accounting System for Shareholding Companies". Since the two systems differ, it is not surprising that different banks show different items on their respective financial reports and even the item with the same title may not represent equivalent measures. Inconsistency of data not only exists in different banks, but also exists in the same bank among different years. Over the past ten years, Chinese banks have witnessed several accounting reforms individually, while these banks do not provide adjusted data for public. These inconsistencies should have limitations that impact the accuracy of our analysis. Actually, the inaccuracy of data is one of the major obstacles in Chinese research and it is anticipated that such situation will be improved after China government promulgates more uniform and transparent accounting practices.

Another limitation of the study concerns the selection of interviewees and the use of questionnaire. Only one interviewee was selected in each bank, as a result of which, the interviewee's opinion might not be representative of the bank. Though the author planned to mail questionnaires to more senior managers for them to write down answers before interview, they were unwilling to do so since they were so busy that they only accept interviews. Therefore, the study can be further enhanced by conducting telephone interviews or face-to-face interviews with more senior managers. In addition, as the questions relating to personal perception and opinion towards banking industry, the findings in this study may suffer from a certain degree of subjective bias.

### *6.4 Possible further research*

As China entered WTO, more and more attention will be paid to Chinese banking industry. Currently, few studies have been done in this field and due to the data limitations. The Chinese banking industry is still only understood and explored partially. It is highly recommended to further enhance the knowledge of Chinese banking industry, which is not only beneficial to Chinese banks and government, but also to foreign banks. From author's point of view, future research on Chinese banking industry can be conducted in the following areas:

First, our analysis has focused on the consolidated performance of each bank but missed the study on performance of the same bank in different regions. Due to the unbalanced economic development among regions, regional inequality should be a factor that influences banks' performance. Furthermore, the network whether it is national or regional should impact banks' performance as well. Thus it is highly recommended that future research take more factors into regression model.

Second, besides the research of SOBs and shareholding banks, study can also be conducted on those small financial institutions such as urban and rural credit cooperatives, as well as city commercial banks. They are also an indispensable part in banking system since most small and medium non-state-owned enterprises, which play more and more important role in national economy, lend money from these financial institutions. To study these financial institutions should be of great importance to the development of the enterprises we mentioned and Chinese economy.

Third, as Chinese government advocates more transparent and standardized information disclosure, Chinese banks will release more consistent, accurate and detailed data. Future researcher can make use of these data to conduct detailed study on bank's performance (for example, the study of banks' credit risk) and sophisticated study by employing more financial ratios calculated through the detailed data.

Last but not the least, future research can adopt case study as a method to get in-depth analysis of banks. The present study only tries to generalize the procedure or methods employed in Chinese banks, while the specific mode of each bank is not presented. For example, the thesis only gives a generalized procedure that banks use to extend a loan, while the particular procedure each bank employs and concrete problems and difficulties each bank faces in credit management are not described in detail. In addition, the case study of two varying types of banks can be adopted as a way of comparing difference in the performance of banks. Therefore, it is highly recommended that case study be an effective research method to study Chinese banks especially when rich and accurate data are not available in current Chinese banking industry.

# Appendix 1 Basic Interview Information

## Time and Banks interviewed

The interview was conducted in March 2001, starting from Shanghai, Beijing, Shenzhen and ending in Guangzhou. There are totally ten banks that accept interviews, including central bank --PBOC (Guangzhou branch), four state-owned banks, and five shareholding banks. The interviewed banks are listed in the following table.

There are various reasons for each bank to be chosen:

First, convenience. Without the so-called connection, it is hard to interview those senior managers in banks, especially when the interviews lasted 3 hours long. My chief supervisor, Dr. John Lee, contacted most banks for me and Professor Zhang in Xiamen University helped contact other banks.

Second, the reason why the four SOBs were all chosen is that each SOB has its problem since they specialized in different areas formerly. The investigation into each SOB will gain us a clearer picture of their recent reform measures.

Third, Bank of Communication is the biggest shareholding bank in China and it shares the characteristics of both four SOEs and shareholding banks. Through the investigation of this bank, some special phenomena are hoped to gain.

Fourth, the reason why three other shareholding banks were chosen is that Shenzhen Development Bank and Shanghai Pudong Development Bank were established by local government, while China Merchants Bank was established by dozens of state-owned enterprises. From the interviews of them, the difference of between the two types of banks is hoped to be obtained.

## Interviewees

The list of interviewees can be found in the following table. Before the interview was conducted, the questionnaires were faxed or mailed to interviewees. One day is prepared for the senior managers' convenience. The interviews, which lasted 2-3 hours, were conducted in a separate meeting office of each bank to avoid the outside interference. Luckily, the interviewees are patient and cooperative and answered all the questions listed in the questionnaire. For the information of questionnaire, please refer to Appendix 2.

## Basic information on the interviews

| Location | Banks interviewed | Interviewees | Position of interviewees |
|---|---|---|---|
| Beijing | Bank of China | Mr. Chen Bin | Manager of Risk Management Department |
| | Agricultural Bank of China | Mr. Song Anping | Secretary of President |
| | China Construction Bank | Mr. Liu Huiyong | Chief of Research Center |
| | Industrial and Commercial Bank of China | Ms. Zhang Xiaoyan | Manager of Project Finance Department |
| | Minsheng Bank | Mr. Gao Feng | Deputy Manager of Corporate Banking Department |
| Shanghai | Bank of Communication | Mr. Zhou Liqun | Deputy Manager of International Banking Department |
| | Shanghai Pudong Development Bank | Ms. Yang Yixia | Researcher of Research & Development Department |
| Guangzhou | The People's Bank of China Guangzhou Branch | Mr. Ji Weimin | Manager of Research & Development Department |
| Shenzhen | Shenzhen Development Bank | Mr. Chen Jian | Manager of General Office |
| | China Merchants Bank | Ms. Li Daner | Manager of Human Resources Department |

# Appendix 2 Questionnaire for Interviews

## 面访话题 (股份制银行)

| 說明 |
|---|
| 1. 本面访仅作学术用途，對貴银行所提供的資料將予以保密。 |
| 2. 請根据您所知道的實際情况回答問題。 |
| 3. 被訪者應為熟悉该银行业务的高级经理人员。 |
| 4. 贵银行可在本研究完成后向調查者申請索取有關研究報告書。 |

一. 政策、法律环境 (Policy & Legal Environment)

- 从一个股份制商业银行的角度，您认为中国人民银行是怎样监管您们的？在政策上与国有银行有何不同？您又有何建议？

  From the perspective of a shareholding bank, what do you think of the supervision by PBOC? What is the difference in policies that treat SOBs and shareholding banks? And what are your suggestions?

- 商业银行法，中国人民银行法，贷款总则，担保法的实行在实践中遇到什么问题？

  What kind of problems are you confronted with in the practice of 'commercial bank Law, PBOC Law, Loans General, and Guarantee Law?

- 您认为目前政策环境(法律，央行监管，国家政策的扶持)有什么需要改善的地方？

  What are your suggestions to improve current policy environment (legislation, central bank's supervision, and support from government)?

二. 组织架构与治理机制 (Organization Structure & Corporate Governance)

- 许多股份制国有企业出现所谓"一权独占"或"一权独大"的局面，致使股份制改革并没有为企业带来真正的转型。您认为中国的股份制银行是否按严格意义的股份制治理机构来运行？存在那些不足？

  Many shareholding state-owned enterprises are "wholly state held" or "mainly state held". The fact prevents the enterprises from exercising shareholding mechanism. Do you think the same problems lie in Chinese shareholding banks? And what are the derivative problems, in detail?

- 民生银行作为中国号称的第一家私有银行，您是怎么看待它与其他股份制商业银行不同的？(组织架构、治理机制、经营理念、贷款的发放等方面)

  As the first non-state-owned Chinese bank, how does Minsheng Bank act differently from other shareholding banks in terms of organization structure, corporate governance, management philosophy, and loans management?

- 建行以来，有没有进行组织、管理架构的改革？现行的架构是怎样的？有何成效？

  Has the bank undergone any organizational/structural reform since the foundation? If so, what are the consequences of the reform? And what is the current structure?

- 如果要您概括贵银行的企业文化，您会怎么说呢？

  How will you describe the bank's corporate culture?

三. 贷款管理及风险管理 (Loans & Risk Management)

- 现在发放贷款还受到政府的干预吗？干预表现在哪方面？

  Are the loans decisions still interfered by government? And in what way?

- 是否发放所有的贷款都需要抵押品？通常什么样的抵押品被使用？哪一类抵押品最多用？

  Do all the loans require collateral? Generally what kinds of collaterals are accepted? And what collaterals are used most frequently?

- 贵银行是怎样预测、防范、控制信贷风险的？政策上有无特别规定？

  How does the bank forecast, prevent and control the credit risks? Is there any specific regulation?

- 贵银行是怎样进行坏帐的管理的？

How does the bank manage the bad loans?

- 贵行如何进行风险管理？遇到什么障碍？

  How does the bank manage risk? What kinds of obstacles do you meet?

四. 银行发展的分析 (The Prediction of the Development of Bank)

- 您认为什么是你们银行业务发展的最大障碍？

  What do you think is the biggest obstacle for the development of your bank?

- 您认为是什么因素促使你们银行的成功？

  What do you think are the factors attributing to the success of your bank?

- 与四大银行(股份制银行)相比，您认为你们的弱势和优势分别是什么？与外资银行相比呢?

  What will be the advantages and disadvantages of your bank when competing with the four SOBs (shareholding banks)? And when competed with the foreign banks?

- 您怎么看待目前外资银行业对中国银行的影响？加入世贸，您认为你们银行将怎样调整以迎接挑战？

  What do you think the influence of entry of foreign banks on Chinese banks? And what your bank will do to accept the challenge after the China's entry of WTO?

- 您认为银行间的并购是否会成为加入世贸中国银行业提高竞争力的一个途径？届时，贵银行又有何对策呢？

  Do you think that the acquisition and merger between the banks will be a useful way for the Chinese banks to enhance the competitiveness after the entry of the WTO?

- 您如何看待银行的混业经营?

  What is your opinion of doing commercial banking, investment banking and insurance business in one bank?

**********谢谢您的合作和支持！**********

**********Thank you for your cooperation and support!**********

# Appendix 3 Credit Report by Customer Manager

| 1. Basic Information of the enterprise | | | | |
|---|---|---|---|---|
| Location | | Legal Representative | | |
| Time of Establishment | | Time of opening account | | |
| Registered Capital | | Paid in Capital | | |
| Legal Person Certificate Code | | Loan Certificate Code | | |
| Investor and its percentage | | | | |
| Business Scope | | | | |
| Organizational Structure | | | | |
| Performance | Year | Gross Assets | Net Assets | Total Revenue |
| | | | | |
| | | | | |

| 2. The quality of the enterprise |
|---|
| The relationship between board of directors and general manager (Who is the final decision maker) |
| The quality of managerial personnel. Basic information on major member of board of directors including education, work performance, etc. |
| The competitiveness in the market including the technology, products and development proposals |
| |

| |
|---|
| 3. Evaluation |
| **3.1 The quality of assets and evaluation of financial condition** |
| The financial strength of the enterprise, ability to pay back loans and credit record. |
| Analyze the items including account receivable, long-term investment, account payable and big projects. |
| |
| **3.2 The operation & management and economic performance** |
| The operation and internal management of the enterprise. Current major business. |
| The revenue and sources of profits. Future sources of profits. |
| |

| 4. The purpose and use of the loan |
| --- |
| |
| 5. Appraisement of guarantor and collaterals |
| |

| 6. Business transaction in our bank and current credit record |
|---|
| |
| **7. The opinion and suggestion of customer manager** |
| |

# Appendix 4 The Departments in Charge of Credit & Loan in Chinese Banks

| Bank | Departments |
|---|---|
| Industrial & Commercial Bank of China | Credit Audit Committee |
| | Credit Evaluation Committee |
| | Industrial & Commercial Credit Dept. |
| | Project Finance Dept. |
| | Housing Finance Dept. |
| | Asset Risk Management Dept. |
| Agricultural Bank of China | Credit & Loan Dept. |
| | Corporate Banking Dept. |
| | Agriculture Loan Dept. |
| | Real Estate Loan Dept. |
| | Risk Management Dept. |
| Bank of China | Risk Management Committee |
| | Risk Management Dept. |
| | Corporate Banking Dept. |
| | Asset Protection Dept. |
| ------------To be continued------------ | |

| Bank | Departments |
|---|---|
| **China Construction Bank** | Risk Control Committee |
| | Credit Management Committee |
| | Directive Committee for Small & Medium Enterprise Credit |
| | Corporate Banking Department |
| | Real Estate Credit Department |
| | Special Credit Department |
| | Risk Control Department |
| **Bank of Communications** | Credit Management Dept. |
| | Marketing Dept. |
| | Risk Management Dept. |
| **Guangdong Development Bank** | Credit & Loan Dept. |
| | Asset Management Dept. |
| **China Everbright Bank** | Credit Audit Committee |
| | Credit Management Dept. |
| | Corporate Banking Dept. |
| | Asset Protection Dept. |
| **CITIC Industrial Bank** | Credit Audit Dept. |
| | Corporate Banking Dept. |
| | Asset Protection Dept. |

| ------------To be continued------------ | |
|---|---|
| **Bank** | **Departments** |
| **China Merchants Bank** | Risk Management Committee |
| | Risk Control Department |
| | Corporate Banking Dept. |
| | Asset Protection Dept. |
| **China Minsheng Bank** | Credit & Loan Examination Committee |
| | Asset Management Dept. |
| | Risk Management Dept |
| | Corporate Banking Dept. |

Source: Websites of all these banks.

# Reference

## *Papers/Books*

Anonymous, 1995. "China's Banks Rated Bottom of Moody Class." *The Banker*, No.145, pp.2-3.

Anonymous, 1996. "China's Financial Revolutionary." Economist, August, pp.340.

Anonymous, 1998. "China: Recapitalizing the Big Four banks." Bank Watch website: http://www.banktouch.com/system/updates/china/chi20041998.pdf

Anonymous, 1998. "The Worst Banking System in Asia." *The Economist*, May, pp. 65-69.

Anonymous, 1999. "China's Banking Reform and WTO." Hong Kong Trade Development Council website: www.tdctrade.com/econforum/sc/991203.htm

Anonymous, 2001. "Four Asset Management Companies." Unirule website: http://www.unirule.org.cn/Forum/macrochina113.htm#_Toc525358643

Anonymous, 2001. "Some Hot Topics in Research of Civil Law & Commercial Law in Today's China (2)." Law info China website: http://www.lawinfochina.com/LegalForum/hottopics/displayContent.asp?ID=25

Anonymous, 2001. "The accounting challenges that China will face after the entry of WTO." Huaxia Dadi website: http://www.edu-edu.com.cn/hx_new/kuaiji/shidian/hysd200111015.html

Anonymous, 2001. "The Downsizing of Employees in Banks: A Silent Revolution." Sina news website: http://finance.gd.sina.com.cn/o/20011210/152995.html

Anonymous, 2001. "The Inevitable Trend for Shareholding Reform of State-owned Banks." Sina news website: http://finance.sina.com.cn/b/20010927/112043.html

Benston GJ, and Smith CW, 1976. "A Transaction Cost Approach to the Theory of Financial Intermediation." *Journal of Finance,* No. 31, pp. 215-231.

Berger, Allen N., 1995. "The Relationship Between Capital and Earning in Banking." *Journal of Money, Credit and Banking*, Vol. 27, No. 2, pp. 432-56.

Cargill, Thomas F. and Parker, Elliott, 2001. "Financial Liberalization in China, Limitations and Lessons of the Japanese Regime." *Journal of the Asia Pacific Economy*, Vol. 6, No. 1, University of Nevada website: http://unr.edu/homepage/elliottp/jape2000.html

Chen, Fenshen, 1999. *Big Transformation -- The rethinking of State-owned Enterprises Reform.* The People's Press: Beijing, China.

*China Daily*, "Banks Urged to Prepare for WTO." November 2001.

China Finance Society, 1999. *Almanac of China's Finance and Banking*. China Financial Publishing House: Beijing, China.

Cooper, Chris and Zheng, Eric, 1998. "State-owned Enterprises Reform in China." *International Business*, Vol.11, No.4, pp.22-23.

Dai, Xianglong, 2001. "Five Years' Reform For State-owned Banks in China." China Internet Information Center: www.china.org.cn/baodao/english/newsandreport/001may/new10-3.htm

Diamond, D., 1984. "Financial Intermediation and Delegated Monitoring." *Review of Economic Studies*, Vol. 51, pp.393-414.

Dong, Yanling, 1999. "The Financial Support to the Small and Medium Enterprises in China." *Shandong Finance*, March, pp.29-30.

Dornbusch, Rudi and Giavazzi, Francesco, 1999. "Heading off China's Financial Crisis." BIS website: http://www.bis.org/publ/plcy07b.pdf

Fama, E. and Jensen, M.C, 1983. "Separation of Ownership and Control." *Journal of Law and Economics*, Vol.26, pp.301-325.

Gong, Haochen and Dai, Guoqing, 1997. *Finance Is the Core of Modern Economy*. People's Press of Shanghai: Shanghai, China.

Guan, yu and Wang, Chunxian, 1998. "The Effects Brought by Entry of WTO on the Banks and Corresponding Measures." *International Finance*, August, pp.59-62.

Haslem, John A, 1968. "A Statistical Analysis of the Relative Profitability of Commercial Banks." *The Journal of Finance*, March, pp.167-176.

Haslem, John A., Bedingfield, James P. and Stagliano, A.J., 1985. "An Analysis Of Liquidity Measures and Relative Bank Profitability." *Akron Business & Economic Review*, Vol.16, No.4, pp.37-43.

He, Jilun, 1998. "The Development of State-owned Banks, State-owned Enterprises and Capital Markets in China." *Finance and Trade*, April, pp.10-15.

Jensen, C. Michael and Meckling, William, 1976. "Theory of the Firm: Managerial Behavior, Agency Cost, and Capital Structure." *Journal of Financial Economics*, Vol.3, October, pp.305-360.

Jiang, Xianling, 1999. "The Globalization of the Financial System and the Development Strategy of Banks in China." *International Finance*, July, pp.65-67.

Jiao, Jingpu, 1999. "The Strategic Restructure of China's Financial System." *Finance Research*, September, pp.21-23.

Jiao, Jingpu, 2000. "The Reform and Development of China's Banking Industry after the Entry of WTO." *China Finance*, January, pp.11-14.

Kim, Mihwa and Kim, Il-woon, 1997. "The Structure-profit Relationship of Commercial Banks in South Korea and the United States: A Comparative Study." *Multinational Business Review*, Vol. 5, No.2, pp.81-91.

Lanchner, David, 1996. "His Bank Looks a Lot Like Its State-owned Competitors." *Global Finance*, October, pp.24.

Lardy, Nicholas R, 1998. "The Challenge of Bank Restructuring in China." BIS website: http://www.bis.org/publ/plcy07a.pdf

Lardy, Nicholas R, 2000. "When Will China's Financial System Meet China's Need?" BIS website: http://www.bis.org/publ/plcy07b.pdf

Lardy, Nicholas R, 2001. "China's Worsening Debts." BIS website: http://www.bis.org/publ/plcy07k.pdf

Laurence, Henry, 1999. "Financial System Reform and the Currency Crisis in East Asia." *Asia Survey,* Vol. XXXIX, No. 2, pp.348-373.

Lee, Wai Sing John, 2000. "Banking Reform in China (1978-1998) – A Review and Appraisal." *Asian Profile*, Vol. 28, No.3, pp.169-185.

Leung, Man-Kwong and Mok, Vincent Wai-Kwong, 2000. "Commercialization of Banks in China: Institutional Changes and Effects on Listed Enterprises." *Journal of Contemporary China*, Vol.9, No.23, pp.41-52.

Li, Shanling, Liu, Feng, Liu, Suge and Whitmore, G.A., 2001. "Comparative Performance of Chinese Commercial Banks: Analysis, Findings and Policy Implications." *Review of Quantitative Finance and Accounting,* Vol.16, pp.149-170.

Liu, Chuangzhe, 1998. *The Analysis of Credit Risk in SOBs.* The Press of China University for Mineral Industry: Xuzhou, China.

Liu, Shijing, 1991. "The Inborn Contradictions of Publicly-owned System and According Solutions." *Economy Research*, July, pp.34-45.

Lloyd, Williams, D.M., Molyneux, Phil and Thornton, John, 1992. "Bank Mergers: Integration and Profitability." *Journal of Financial Services Research*, pp.35-55.

Lloyd, Williams, D.M., Molyneux, Phil and Thornton, John, 1994. "Market Structure and Performance in Spanish Banking." *Journal of Banking and Finance*, Vol.18, pp.433-443.

Ma, Jun, 1996. "China's Banking Sector: From Administrative Control to a Regulatory Framework." *Journal of Contemporary China*, Vol.5, No.2, pp.155-169.

Martinez, John E. and Courington, John M, 1993. "Bank Performance and Risk: Evidence from the Energy-producing States." *Journal of Applied Business Research*, Vol.9, No.2, pp.1-9.

McCarthy, Michael P. and Handorf, William C., 1981. "How Requirement for Big Capital Ratios Inhibit Banks." *ABA Banking Journal*, June, pp.52-61.

Mok, Vincent Wai-Kwong and Leung, Man Kwong, 2001. "Joint-stock System in China: Agency Problems and Governance Mechanisms." *Asian Profile*, December, pp.455-463.

Nagashima, Akira, 1999. "Options for China's Financial System." *A panel discussion chaired by Tommaso Padoa-Schioppa.* BIS website: www.bis.org/publ/plcy07v.pdf

Park, Albert, and Sehrt, Kaja, 2000. "Tests of Financial Intermediation and Banking Reform in China." World bank website: www.worldbank.org/transitionnewsletter/so99/pgs28-30.htm

Parker, Elliott, 1995. "Prospects for the State-owned Enterprise in China's Socialist Market Economy." *Asian Perspective,* Vol.19, No.1, pp.7-35.

Pei, Minxin, 1998. "The Political Economy of Banking Reforms in China, 1993-1997." *Journal of Contemporary China*, Vol.7, No.18, pp.321-350.

People's Bank of China, 2001. "Guidelines on Risk-Based Loan Classification." PBOC website: http://www.pbc.gov.cn/english/news/show.asp?b=23

*People's Daily*, 2001. "State-owned Commercial Banks Asked to Cut Bad Debts." 01 November.

Perkins, Dwight, 1994. "Completing China's Move to the Market." *Journal of Economic Perspectives*, Vol.8, No.2, pp.23-46.

Pi, Lynn and Timme, Stephen G., 1993. "Corporate Control and Bank Efficiency." *Journal of Banking and Finance*, Vol.17, pp.515-530.

Revell, J.R.S., 1991. "Changes in West European Public Banks and Their Implications for Spain." Research Monographs in Banking and Finance, No.9. pp.51-80.

Rose, Peter S., 1992. "Interstate Banking: Performance, Market Share, and Market Concentration Issues." *Antitrust Bulletin*, Fall, pp.601-30.

Rosenthal, Elisabeth, 2002. "Bank of China's Mounting Problems." *The New York Times*, 01 February.

Samolyk, Katherine A., 1994. "U.S. Banking Sector Trends: Assessing Disparities in Industry Performance." *Economic Review – Federal Reserve Bank of Cleveland*, Vol.7, pp.2-17.

*Security Daily*, 2001. "The Shareholding Reform of State-owned Banks after WTO." 27 September.

Shleifer, Andrei and Vishny, Robert W., 1997. "A Survey of Corporate Governance." *The Journal of Finance*, Vol. LII, No.2, pp.737-776.

Tang, Xiaoguang, 1999. "Restructuring the State-owned Banks." *Finance Research*, September, pp.15-18.

*The Banker*, 2001. "Top 1000 World Banks." July, pp.22-23.

Thygerson, Kenneth J., 1995. *Management of Financial Institution*. Harper Collins College Publishers: New York.

Wang, Guo-song, 2001. "Interest Rate Control and Marketization in China." Institute of World Economics and Politics Chinese Academy of Social Science website: http://www.iwep.org.cn/wec/english/articles/%202001_06/6wangguosong.htm

Wang, Ping, 2001. "The Marketization of Interest Rate and Risk Management of China's Commercial Banks." *The Research for Investment*, March, pp.14-17.

Wang, Xiaofang, 1998. "The Lessons from the South-Asian Crisis." *Finance and Trade*, July, pp.27-29.

Wang, Xiao-ya, Li, Zhen-jian, and Yuan, De-fa, 2000. *Great Breakthroughs: China's Financial Reforms at the Turn of Centuries*. Beijing China Finance Press: Beijing, China.

Wei, Jie, 1999. *The Fundamental Issues of State-owned Enterprises' Reform and the Development of the Theory*. China's Communist Party Press: Beijing, China.

Wong, Y.C. Richard and Wong, M.L. Sonia, 2001. "Competition in China's Domestic Banking Industry." *Cato Journal*, Vol. 21, No.1, pp.19-41.

Wu, Bin, 1998. "The Examination of Competition between Chinese and Foreign Banks from the Perspective of Game Theory." *The City Finance Forum*, Vol.3, pp.56-58.

Wu, Xiangjiang, 1997. "Rethink the Operation Mechanism of State-owned Banks." *The Forum of City Finance*, March, pp.13-16.

Yi, Cheng, 1999. The Analysis of Financial Market and State-owned Enterprises. China Economies Press: Beijing, China.

Yu, Yong-ding, 2001. "A Review of China's Macroeconomic Development and Policies in the 1990s". Institute of World Economics and Politics Chinese Academy of Social Science website:
http://www.iwep.org.cn/wec/english/articles/2001_06/6yuyongding.htm

Zhang, Wei, 2002. "What Have Foreign Shareholders Brought to Domestic Banks?" Sinopolis website: www.sinopolis.com/archives/topstory/ts_020123_01.htm

Zhao, Haikuan, 2001. "The Establishment of Credit Evaluation System." China Central TV website: http://www.cctv.com/life/baike/090302_605.html

Zhou, Lin, 2000. "Development, Opportunities and Strategies of China's Shareholding Commercial Banks." *Conference paper from Senior Finance Forum*, Beijing, May.

## *Yearbook*

*Almanac of China's Finance and Banking*, (1993-2001). China Financial Publishing House: Beijing, China.

*China Statistical Yearbook*, (2000). China Statistics Press: Beijing, China.

*International Statistical Yearbook*, (1996,1997). China Statistics Press: Beijing, China.

## *Websites of Governments and Financial Institutions*

| | |
|---|---|
| Agricultural Bank of China | http://www.abocn.com/ |
| Agricultural Development Bank of China | www.adbc.com.cn |
| Bank of China | http://www.bank-of-china.com/ |
| Bank of Communications | http://www.bankcomm.com/ |
| China Construction Bank | http://www.ccb.com.cn/ |
| China Economic Information Network | www.cei.gov.cn |
| China Everbright Bank | http://www.cebbank.com/ |
| China Merchants Bank | http://www.cmbchina.com/ |
| China Minsheng Banking Corp. Ltd | http://www.cmbc.com.cn/ |
| China Security Regulatory Commission | www.csrc.gov.cn |
| CITIC Industrial Bank | http://www.citicib.com.cn |
| CitiGroup | www.citigroup.com |
| Export-Import Bank of China | www.chinaexim.gov.cn |
| Federal Reserve of United States | http://www.federalreserve.gov/ |
| Fujian Industrial Bank | http://www.fib.com.cn/ |
| Great Wall Asset Management Corporation | www.gwamcc.com.cn |
| Guangdong Development Bank | http://www.gdb.com.cn/ |
| Hong Kong and Shanghai Bank Corporation | www.hsbc.com |
| Huarong Asset Management Corporation | www.chamc.com.cn |
| Huaxia Bank | http://www.hxbank.com.cn |

| | |
|---|---|
| Industrial and Commercial Bank of China | http://www.icbc.com.cn/ |
| National Bureau of Statistics of China | www.stats.gov.cn |
| Orient Asset Management Corporation | www.coamc.com.cn |
| People's Bank of China | www.pbc.gov.cn |
| Pudong Development Bank | http://www.spdb.com.cn/ |
| Shenzhen Development Bank | http://sdb.com.cn/ |
| State Development Bank of China | www.cdb.com.cn |
| Xinda Asset Management Corporation | www.cinda.com.cn |