

Globalization of Chinese commercial banks

By

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A research project submitted in partial fulfillment of
the requirements for the degree of Master of Finance

Saint Mary's University

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October 9, 2014

Acknowledgements

I would like to sincerely express my thankfulness to my supervisor Dr. J. Colin Dodds for all his help, advice and encouragement through the whole project. I would also thank him for all his efforts, guidance and all the time he spent with me which were really valuable to me. Besides that, I want to thank for all my friends and my family who helped me go through the project and gave me huge support. Last but not least, I would like to thank all the professors who have imparted knowledge and enlightened me with the thought of doing this project.

Abstract:

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The purpose of this study is to show the current situation for the globalization of Chinese banks. We begin with a strong Chinese economy and a low degree of Chinese banks' internationalization. We discuss the advantages and disadvantages of commercial banks' globalization based on the traditional multi-national enterprise theory. After that, in Chapter 3, a Logit model is used to test the general effect of culture, economy, and political policies on the probability of success of banks international expansion. The history of six well developed international banks is studied to generate the sample of 23 banks. In the end, the specific factors and opportunities for Chinese commercial banks are taken into consideration, providing a more practical and meaningful discussion for Chinese commercial banks.

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Chapter 1: Background

1.1 World economy

For this 21st century, especially after the 2008 financial crisis, the world economy is forming a new order. Firstly, western countries face lots of economics issues.

European governments' debt and financial fraud have turned into big issues and European countries experienced a debt crisis after 2009. Although the American economy has now emerged from the financial crisis, it still has to face its international debt load and a persistent low employment rate. Secondly, the emerging economies kept on growing. Based on international exchange rates, by the end of 2011, the GDP of China was \$7.29 UD trillion, as the second largest in the world. Brazil had a GDP of \$2.49 US trillion, Russia of 1.85, and India of 1.68, which rank them as 6th, 9th and 11th in the world. Not surprising, the contribution of BRIC GDP to global GDP increased rapidly, from -0.6% in 1990 to 30% in 2010. Thirdly, the world economy became more imbalanced, with emerging economies continuously having net capital outflows, and America, the largest net capital inflow, which has made it the largest debtor nation.

After the financial crisis, economy globalization entered a period of adjustment.

International capital became necessary to provide liquidity and to stimulate the world economy. Additionally the need for global governance reforms has been recognized. The change from the G8 Summit to a G20 is one example of the growing importance of emerging markets to the world economy, and they are now increasingly playing more important roles in things like financial regulatory and international monetary system reform, and there is more cooperation between emerging and developed economies. Although emerging markets were also affected by the recent financial crisis, they will still be an important engine for the world economy for a period of time due to their unfinished industrialization process, huge domestic demand, adequate foreign exchange reserve and large populations. As a result there will be more of a balance between North America/Europe and Asia.

Another trend of the world economy is diversification. From a geographic prospective, Asia now occupies 1/3 of total volume of global trade and both Europe and America have adjusted their economic policies to place more weight on Asia. If we focus on specific countries of the World Bank, there will be six former emerging economies—Brazil, China, India, Indonesia, Korea and Russia by 2025 (Global Development Horizons 2011 Multipolarity: The New Global Economy) that will become dominant economies. As a result the world economy will be more balanced integrated and unified.

1.2 China's economy

In 2012, the growth rate of Chinese GDP for the first time since the economic reform were introduced slipped below 8%. Most economists now believe that China is at a key turning point. Just like President Xi's speech at the Boao Forum for Asia in 2013, the Chinese economy is changing into Pnormal, which has three characteristics.

(i) Changing growing speed from high gear to medium-high

It is impossible and not necessary to keep the super high growth rate. The cheap labour force and huge demand from Europe and America gave China a competitive advantage and good opportunities to develop fast. But the growth has a trade-off in terms of the environment. Nowadays, the Chinese labour force is losing its price advantage and the world economy is experiencing the aftermath of the financial crisis. Considering these bad effects, it is rational to decrease the speed of growth.

(ii) Optimize the structure

The past decade was unbalanced. From the industrial perspective, the manufacturing faced excess productive capacity while the service industry was still insufficient in capacity. From a geographic prospective, south-east cities grew rapidly while cities in the west are still weak in economic development. The differences between large and small cities are even larger. From financial perspective, the bank sector is still a monopoly.

But all these are going to change in the future based on the government's recent report. Manufacturing industry occupied more than 40% of GDP since 1990. The decrease of demand after the financial crisis led to excess capacity, and now under the effect of the Central Committee, the Chinese economy will certainly put more weight on service industries. For the financial industry, we are now witnessing the establishment of private banks and security companies. Financial products are now more diversified and with further regulating changes, the financial services industry will be more innovative.

(iii) Adjust for appropriate policies

During the financial crisis, the Chinese government also used a policy of Quantitative Easing, with total reserve rates and interest rates as the tool. The new target is to use open market operations to achieve a more stable monetary policy.

1.3 The current situation of Chinese commercial banks

Due to the high speed of economic growth and easy monetary policy, the Chinese bank industry maintained a high extension rate in the past few years. By the end of 2011, the total assets in the banking industry were US \$ 18.9 Trillion (113.3 Trillion RMB), which increased 18.9% from year 2010. With commercial banks occupying 63.5% of total assets. The weighted average capital adequacy ratio was 12.71%, and the capital adequacy ratio of all 390 commercial banks were above 8%. Turning to the

quality of assets, the non-performing loan ratio was 1.77%, which is US \$ 0.175 trillion (1.05 trillion RMB). For commercial banks, it was USD 71.3 Billion (427.9 Billion RMB), giving a 0.96% non-performing loan ratio. The banks also had a high liquidity level of 44.7%.

Compared to the world average, Chinese commercial banks have large total assets, high capital adequacy ratios and high liquidity levels. But still they have problems of low asset quality, poor experience in operations and risk management. All these problems need to be appropriately handled, or they can have a bad effect on Chinese economic development and its stability.

Chapter 2: Globalization and international banking

In this chapter, we will only focus on the economic forces and ignore all things such as a firm's social responsibility and environment responsibility, which is in line with traditional multi-national enterprise theory (MNE). In the trend of globalization, multi-national enterprises face different cultures, history, institutions, corporate governance, exchange rates, and politics. Globalization means an expanded set of business opportunities for trade, production and investment, an expanded set of risks and operational management challenges and sourcing financing globally. So there should be both advantages and disadvantages for banks to go global.

2.1 Advantages:

(1) Diversifying investment in different countries lowers political risk. If the bank were to keep all its money in one country, all its assets will be affected if there is a political event such as wars. By diversifying the portfolio into different countries, it will lower the risk of political events because these events may not happen in all the countries at the same time.

(2) Diversifying portfolios in different currencies will lower exchange rate risk. This

is very similar to the political risk. If the bank has its entire portfolio in one currency, the true value of its total assets may vary a lot in another currency due to the exchange rate. By diversifying currencies, it will lower exchange rate risk because the exchange rates of different currencies becomes an automatic stabilizer.

(3) Expanded business opportunities of trading, production and investment are possible. Their production may have a better market in other countries and they also have more investment opportunities. Additionally there can be a chance of finding cheaper labor and resources.

(4) More sources of financing; multi-national banks may finance their investment from world-wide investors, so they can afford bigger projects and be more liquid. This can relate to higher revenue and lead to the increased safety for banks.

2.2 Disadvantages:

(1) While different cultures can be an advantage as they provide opportunities, they can also be a disadvantage. Each foreign country is unique and its culture and history are not always understood by Multi-national enterprises. So entering a new culture can be difficult. Some cultures are conservative, and do not welcome firms from other countries, and they may find that there is no market or very little market in the foreign country.

Secondly, it can be costly to enter a new country. Firms' structures and traditions may be based on or affected by their local culture. To move into a new culture may need a huge effort and a lot of time to change to adapt to the new environment. These changes can affect their products and services, and even their fundamental structures. There are a lot of cases of failures in foreign markets due to the inability to adapt to the new culture. For example, one important reason for the famous failure of the merger of Daimler-Benz with Chrysler in 1998 was their different cultures. The German firm, Daimler-Benz was very rigid and serious compared to Chrysler which was more of an advocate for creativity and teamwork.

(2) Foreign government policies, including tax and regulatory framework can also be a challenge. Some countries have a foreign friendly government policies to attract foreign investment, which can help the firms to some degree. But still, for most firms, they will face a new government that they do not know well. They will have to study policies and regulations. Many Chinese companies which were doing well and not dumping in America were forced to return without even knowing it was due to US anti-dumping actions.

Secondly, some countries are protectionist. Tariff and non-tariff barriers protect their local industry. Although these have been proved to be not efficient in an economy, it is still present in many countries. This can be a disadvantage and challenge for Multi-

national enterprises.

(3) There are still systematic risks that they cannot eliminate. Although by investing in different countries, Multinational enterprises can lower their political risk and exchange rate risk, there is still systematic risk. The 2008 financial crisis is an example that firms still have to face risks no matter how well they have diversified their portfolios.

(4) Changes in financial theories; MNEs must modify finance theories such as capital budgeting and cost of capital because of foreign complexities. And they have to use modified financial instruments, including derivatives such as options, futures and swaps.

Chapter 3: Qualitative analysis

In this chapter, which is also the core part of the paper, we want to perform a qualitative analysis to see which factors have positive or negative effects to the success of banks' beginning their overseas expansion. We will use a logit model to do a regression and test factors such as the culture, economy and politics of the target country, and the world's economic cycle. At the end of this chapter, we want to determine if these factors affect the success of banks beginning their expansion. If they do, we need to assess by which direction, and also, which factor is more important? However we understand that some factors are almost impossible or hard to measure, such as culture and policy. So we have to simplify.

3.1 Factors and quantification

First, considering the structure of a logit model as shown in Equation 3.1

$$P = F(Z_i) = \frac{1}{1+e^{-Z_i}}, \text{ Where}$$
$$Z_i = E(Y_i) = \beta_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \dots + \beta_n X_n \quad (3.1)$$

where, Y is a dummy variable, $E(Y_i)$ is the expected value of Y, F is the formula that convert Z_i into the range of (0, 1). P represents the probability.

To be compatible with our analysis, P here means the probability of success of one

bank starting an overseas branch; X_2 represents the similarity in culture of two countries; X_3 represents the economic development level of the target country and X_4 represents the political policy of the target country.

Considering the feature of the logit model, the higher the P means the greater the chance of success, and it also requires the larger Z_i . So we will give the larger value to all these factors that we consider will be “helpful” to the success of expansion. In this way, β_1 will represent all the other factor effects and β_2 to β_4 will represent the weight of that factor. If we obtain a negative number, it means that our assumption of the direction of that factor is wrong, or we can say, that the factor has a different effect than our expectations.

Secondly, the quantification of the factors

(a) Culture: this is to answer how close the two cultures are. The more similar the cultures, the higher the chance of success that the bank has to enter a foreign market.

We can begin with zero,

If the target country has the same language as the bank’s country, then $X_2=1$.

If the target country is located in the same area with the bank’s country, then $X_2=1$.

If the target country has similar a history, traditions and convention with the bank’s country, then $X_2=1$.

Otherwise, $X_2=0$

So, the value of X_2 is constrained into the set of $[0, 1]$. If $X_2=1$, we say the two countries have similarity in culture, and it should be easier for a bank to begin its overseas branches.

(b) The economy of the target country: based on the GDP of the target country, we look for the scale of the economy at the time banks begin their expansion. Data were obtained from the IMF at current prices, in billions USD.

So the value of target country economy X_3 is considered as a continuous variable.

(c) The politics of the target country: based on how rigid the foreign politics policy is, I rate politics into two different levels.

If the policies and governance in target country have more constraints than encouragement on foreign assets and investment, we rate it as 0.

If the country does not have specific policies or has a friendly policies and governance of foreign assets and investment, we rate it as 1.

So, similar to culture, the value of X_4 , politics is constrained into the set of $[0, 1]$. The higher the value of X_4 , the friendlier the policy is, and the easier for the bank to start its overseas branches.

In this way, we have quantified all the factors that we want to test, and the value is sort by the helpfulness of that certain factor. In the next step, we will use this method

to get our sample to do the test.

3.2 Data collection

We obtain the data from studying the history of expansion of the following multinational banks: Deutsche Bank, Allied Irish Banks, Citibank, ANZ, DBS and HSBC.

We can begin with Allied Irish Banks (AIB), a very successful multinational commercial bank, which has the highest trans-nationality index in Ireland. AIB was formed in 1966, and now has more than 50,000 employees and its service covers Ireland, USA, UK, Poland and Germany. AIB began its multinational process in the following order:

Expansion into the UK during the 1970s, through local Irish residents. It developed retail activity in population areas with an Irish immigrant community and focused on a high level of personal service and services to SMEs.

Expansion in US occurred during the 1980s with a minority acquisition of First Maryland Bancorp, later acquired Dauphin Deposit Corp again regionally. The US headquarters were based in Baltimore. The US operation have undergone consolidation through merger and acquisitions. Compared to giants like Citigroup

Inc., AIB is a small regionally based bank.

Expansion into Poland in 1990's was through an acquisition. In 2004 it merged with WBK & BZ to form BZWBK, with a strong regional focus south and west of Poland. Compared with other EU new member states, Poland has a weak retail market, but significant growth potential and strong FDI.

So, based on our model, the data we can get from AIB is as follows, (Table 3.1)

Table 3. 1

Bank	Target Area	Culture	Politics	Economy	Success
AIB	Polish	1	1	62.084	1
AIB	UK	1	1	542.452	1
AIB	US	1	1	2,862.475	1

Deutsch Bank has a 135 year history. It is now one of the most important and largest financial institutions in the world and headquartered in Frankfurt. It was formed in 1870, and in 1872, its Shanghai and Yokohama branches opened. But the Asian operations did not make reasonable profits until the 21st century, so that we will consider this as not a successful expansion. Actually, Deutsch Bank made 90 percent

of its profit from Germany until the 1980's.

The first significant acquisition of Deutsch Bank was in buying the Bank of American's Italian branch in 1986. And they made another two in 1989 and 1996 for Morgan Grenfell and Caja Madrid, located in London and Madrid respectively. Based on all these, we can get the following data. (Table 3.2)

Table 3. 2

Bank	Target Area	Culture	Politics	Economy	Success
Deutsche Bank	Italy	1	0	470.040	1
Deutsche Bank	China	0	0	218.154	0
Deutsche Bank	Spanish	1	1	224.368	1

Coming from the City Bank of New York, Citibank National Association is part of Citigroup. After two centuries' of merger and acquisitions, it is now the third largest bank in America, and has branches in more than 50 countries over the world.

Citibank began in 1812 as a financial institution for businessmen in New York. It started to expand its branches in other states at the end of the 19th century and established its first overseas branch in London in 1902. After that, Citibank expanded its services into Singapore, China, and Argentina. Based on all these, we can get the following data. (Table 3.3)

Table 3. 3

Bank	Target Area	Culture	Politics	Economy	Success
Citibank	Argentina	0	1	209.031	1
Citibank	China	0	1	244.980	1
Citibank	Singapore	1	1	0.760	1
Citibank	UK	1	1	136.273	1

The Australia and New Zealand Banking Group Limited (ANZ) is one of the largest four banks in Australia. Formed in 1835 it now has a total market value of \$39.5 billion in Australian dollars (around \$37 billion USD) and more than 20 thousand staff. In 1968, it opened its first overseas office in New York. Only 1 year after that, it opened its representative office in Tokyo. In 1970, ANZ bank merged with the England, Scotland and Australia bank Co., and formed the Australia and New Zealand Banking Group Limited. Then it expanded its services to Vanuatu and Malaysia. Based on all these, we can obtain the following data. (Table 3.4)

Table 3. 4

Bank	Target Area	Culture	Politics	Economy	Success
ANZ	Japan	0	1	1,086.988	1
ANZ	Malaysia	0	0	24.567	1
ANZ	US	1	1	2,862.475	1
ANZ	Vanuatu	1	1	0.121	1

DBS bank limited is the largest commercial bank in Singapore. By the end of 2006, it had a total assets of \$197 billion SGD (around \$129 billion USD) and that made it also the largest company on the Singapore Exchange. Previously known as The Development Bank of Singapore Limited, it was formed in 1968 as a bank to develop investment projects. DBS entered the Chinese market in 1995 in Beijing, and later Shanghai and Hong Kong in 1998. It began its expansion plans in this current century and in the past few years, DBS has finished many acquisition programs including the Bank of the Philippine Islands and the PT Bank Danamon in Indonesia. Based on all these, we can get the following data. (Table 3.5)

Table 3. 5

Bank	Target Area	Culture	Politics	Economy	Success
DBS	China	1	1	390.279	1
DBS	Indonesia	1	0	113.773	1

Headquartered in London, the Hongkong and Shanghai Banking Corporation Limited (HSBC) now has operations in more than 82 countries and regions over the world with around 232,000 employees, and it services more than 125 million customers. Back to its beginning, HSBC was established by Thomas Sutherland in 1864 in Hongkong and Shanghai. One year later, HSBC established one branch in London and one agency in San Francisco, which began to provide services in 1875. It also opened branches in Yokohama, Japan and Thailand in 1866 and 1888 respectively. By the end of the 1800's, HSBC had branches also in India and Singapore. The main function of

HSBC at beginning was to provide financial service for foreign companies in China.

Although it had a global network at the very earliest ages, the main services are for

China and Asia. Based on all these, we can get the following data. (Table 3.6)

Table 3. 6

Bank	Target Area	Culture	Politics	Economy	Success
HSBC	India	0	1	204.242	1
HSBC	Japan	0	1	28.689	1
HSBC	Singapore	1	1	0.760	1
HSBC	Thailand	0	1	68.342	1
HSBC	UK	1	1	36.273	1

With all the data above, we can summarize and illustrate the sample: (Table 3.7)

Table 3. 7

BANK	TARGET AREA	CULTURE	POLITICS	ECONOMY	SUCCESS
AIB	Polish	1	1	62.084	1
AIB	UK	1	1	542.452	1
AIB	US	1	1	2,862.475	1
ANZ	Japan	0	1	1,086.988	1
ANZ	Malaysia	0	0	24.567	1
ANZ	US	1	1	2,862.475	1
ANZ	Vanuatu	1	1	0.121	1
CITIBANK	Argentina	0	1	209.031	1
CITIBANK	China	0	1	244.980	1
CITIBANK	Singapore	1	1	0.760	1
CITIBANK	UK	1	1	136.273	1
DBS	China	1	1	390.279	1
DBS	Indonesia	1	0	113.773	1
DBS	Philippine	1	0	48.971	1
DEUTSCHE BANK	Italy	1	0	470.040	1
DEUTSCHE BANK	China	0	0	218.154	0
DEUTSCHE BANK	Spanish	1	1	224.368	1
HSBC	India	0	1	204.242	1
HSBC	Japan	0	1	28.689	1

HSBC	Singapore	1	1	0.760	1
HSBC	Thailand	0	1	68.342	1
HSBC	UK	1	1	36.273	1
HSBC	US	1	1	120.700	0

3.3 Regression Analysis

We can perform a logit regression to estimate the coefficient of each variable. Here is the process. (Using StataSE 11)

Table 3. 8

```

. logit successornot gdp culture politics
Iteration 0:  log likelihood = -6.7951014
Iteration 1:  log likelihood = -6.3353377
Iteration 2:  log likelihood = -6.1849899
Iteration 3:  log likelihood = -6.1777051
Iteration 4:  log likelihood = -6.1776757
Iteration 5:  log likelihood = -6.1776757

Logistic regression
Log likelihood = -6.1776757
Number of obs   =      23
LR chi2(3)     =      1.23
Prob > chi2    =      0.7447
Pseudo R2     =      0.0909

```

successor~t	Coef.	Std. Err.	z	P> z	[95% Conf. Interval]	
gdp	.0009639	.0029018	0.33	0.740	-.0047234	.0066513
culture	.5659459	1.528222	0.37	0.711	-2.429314	3.561206
politics	1.291684	1.537021	0.84	0.401	-1.720822	4.30419
_cons	.9150853	1.43743	0.64	0.524	-1.902225	3.732395

So, the logit regression follows Equation 3.1 can be written as follows. (Equation 3.2)

Logit $Z = 0.9150853 + 0.5659459 X_2 + 1.291684 X_3 + 0.0009639 X_4$, or,

$$P = F(Z_i) = \frac{1}{1 + e^{-(0.9150853 + 0.5659459 X_2 + 1.291684 X_3 + 0.0009639 X_4)_i}} \quad (3.2)$$

where the coefficient of culture is 0.5659, politics is 1.2917, and GDP is 0.00096. So the similarity in culture, positive political policy and GDP all have positive effects on entering the new market for banks. But a positive policy is more important than the similarity in culture. Considering the coefficient of GDP, $\beta_4=0.0009639$, it will have a statistically significant effect only when the target country has a huge GDP such as the USA.

3.4 Conclusion of the results

From the regression we ran using Stata 11, and the estimated coefficient of the intercept is $\beta_1=0.9150853$, for culture is $\beta_2=0.565946$, politics $\beta_3= 1.291684$, and for GDP, $\beta_4= 0.0009639$. That means, our assumptions are valid. Similarities of culture, friendly policies, and stronger economies help banks entering new markets.

However, one thing we have to notice is that there are still other things that can affect the successful expansion of banks which we did not measure. There include the strength of the bank itself, or the world economic cycle. If we take these into consideration, the results may change.

The other thing we should keep in mind is that the sample here is 23, which is very small. The estimation will trend to be stable only after the sample is big enough. Once the data are more complete, we may use the results as a bench mark to estimate the probability of success for banks entering a new country.

Chapter 4: Opportunities and challenges for globalization of Chinese commercial banks

Until recently banks in China were not really commercial banks but owned by the central government and their levels of operation and management were low. Also because there was not much in the way of international trade, the degree of internationalization of Chinese commercial banks was low. With the rapid growth of the Chinese economy, Chinese commercial banks are now facing historical development opportunities.

Besides the analysis with our model as illustrated in the previous chapter, there are still many special factors that cannot be measured in a regression. Chinese commercial banks have their own advantages and disadvantages when entering a new country. Also, with the development of the internet, online banking and new financial products give Chinese commercial banks other opportunities and challenges in the global market place. Let's begin with opportunities.

4.1 Opportunities:

We want to look for the opportunities from both external market environment and

internally with banks.

If we look at the external market environment in the context of China, it is getting better and becomes an advantage for Chinese commercial banks. First, the Chinese economy is healthy and the political scene is getting stronger, so that provide a good environment for banks to grow. China also has a deeper influence to the world.

Secondly, the capital market is active. Although the Chinese stock market was affected severely by the financial crisis in 2008, now it is recovering from that.

Thirdly, the Chinese RMB is appreciating. This increases the purchasing power which means it is easier for banks to purchase assets overseas now than before. On the other side, RMB appreciation also increases the asset value of Chinese banks, which makes Chinese banks bigger. Fourthly, government support. The Chinese government since 2000 has the strategy known as “Zouchuqu” or “Step Out”, which means the government will both help the development of free trade areas and build regulations which support firms’ globalization. China now is member of many free trade area and the law and regulations also began to come into effect. Things like simplified processes, financial support and tax management all give banks a better chance to begin their services overseas. And fifthly, the 2008 financial crisis and bad world economy situation provide a chance for Chinese commercial banks to merge and make acquisitions.

Chinese commercial banks could not enter the UK and US by virtue of the low capital

adequacy ratios and also the lack of the necessary rules and regulations. After 2007, America experienced the financial crisis which included a slump in the stock market, bank bankruptcy, and depreciation in the US dollar. All these provide opportunities for Chinese commercial banks. Historically, every crisis means a new financial structure will be formed, and a great chance for strong multinational banks to develop. Citi bank and HSBC have increased their international position and influence power by doing acquisitions and expansion when a target country was facing a crisis.

Internally, Chinese commercial banks have been developing rapidly and possess basic competitive power.

First, shareholding reform of state-owned commercial banks is mostly achieved and banks now have a modern regime. After experiencing toxic assets, government recapitalization and IPO's on both the mainland and Hongkong, have given capital strength. Management systems have also improved a lot.

Secondly, advantages on the cost of capital. After the banks' stock reform, banks raised huge funds on a very low cost of capital. Besides that, due to the dynamic performance of stock market in both the mainland and Hongkong, the market value of banks grew rapidly, which gave banks the ability to purchase asset and expand overseas.

The third important advantage that related to banks themselves is their relationship with their customers. After 2002 China joined the World Trade Organization (WTO), so the Chinese economy is increasing related to international trading. On one side, more and more firms now have businesses both in China and overseas so they have demands for the services of multinational banks. On the other side, there are also demands from individuals such as tourists and overseas students, the number of which is also growing and at a dramatic rate.

Last but not least, Chinese commercial banks have gained experience from globalization by providing international services for only 20 years with some of them having branches in surrounding countries or world financial centers. Universities and banks now have international financial personnel and have established the proper management systems for overseas branches.

4.2 Challenges

Although we know there are many opportunities for Chinese commercial banks, we still have to keep it in mind that there are lots of challenges and problems we have to face, such as:

(a) Problems with countries to enter.

For developed countries, most of them now have restrictions or barriers for banks to

enter. For emerging markets, there may be less limitations, but there are also less international services that Chinese commercial banks can provide due to the immaturity of their financial markets. Also, it is more risky to enter emerging markets than to enter a more mature market, which usually has a more stable policy and healthier economic environment.

(b) Low competitive power.

Just as we mentioned earlier in this chapter, Chinese commercial banks now have some competitive power compared to what they are before. But still, the power is very weak compared to banks from western countries. It will take time to gain this ability and competitive strength.

Chinese commercial banks are big but not strong. Typically, Chinese commercial banks have huge market value, and also have very good rank internationally. The ICBC (Industrial and Commercial Bank of China), which is now the largest bank in the world, but due to the short time of completing shareholding reform, they still have a very low market competitive ability. For example, the company's management structure has not changed much from when they were managed by the government, so they cannot adapt to the market economy well and the process of change is slow. The services they provide are mostly traditional services such as deposits and loans, which is markedly different from the well-developed multinational banks. There is of course a lot of room to improve on services and financial products they provide so that they

can compete with western commercial banks. 3) Low rate of using latest financial theories and technologies: the risk control ability and portfolio management ability is low.

Chapter 5: Conclusion

5.1 Conclusions

In the past decade, while the Chinese economy has grown at a dramatic rate, Chinese big four commercial banks completed toxic asset stripping, shareholder reform and IPO's. In addition, new commercial banks developed well and become more profitable. Some Chinese commercial banks exceed the traditional huge banks in the world in terms of their total asset during the financial crisis. But we also have to keep in mind that Chinese commercial banks have flaws in regulatory management and structure of globalization, which can help guide the way of banks in their future development.

Firstly, Chinese commercial banks are now entering a new stage of development. All the Chinese big four are now in the top 10 of World Bank industry in terms of total assets. This is due to both the booming economy of China and the low profitability of western banks. Besides the big banks, city's commercial banks also show very good capability of growth.

Secondly, one advantage Chinese bank has is their high profitability. High rates of return on total assets and return on capital and low operating costs give Chinese banks a high profit margin of around 30%.

Growth is the other advantage of Chinese commercial banks. Through the recapitalization effort by the government, IPO's, mergers and acquisitions, capital strength has grown rapidly, whereas western banks have experienced a hard time during financial crisis and their assets shrank. The strength of Chinese banks now exceed those of Germany in 2008, the UK in 2009, and Japan in 2010, and the scale of Chinese bank industry is almost the same as those of the USA. Compared from growth rates, Chinese banks are only slower than Brazil and Mexico, but the quality of assets is also high.

Fourthly, the risk management ability should be improved. The capital adequacy ratios of Chinese commercial banks are lower than Japanese and European, but at the same level of American. This limits both internal development and the ability to merge and acquire globally. Also, the experiences, measures and estimation ability of risk management are relatively low, and the regulatory system is not complete, which has kept Chinese commercial banks from being the world's best commercial banks.

5.2 Suggestions

A key suggestion is to join the global competition and face the pressure. As Chinese commercial banks now have the strategy of "Step Out" (Zouchuqu), large commercial

banks now have branches in more than 130 countries and areas over the world.

Competition in markets can be a good teacher of Chinese commercial banks which have enjoyed policy protection for years. They need to improve their positions in Asia and expand market share in America and Africa.

Secondly they need to be stable and creative. A modern management model and a more complete regulatory system are necessary for competition overseas. They provide safeguards of the technology and production innovation. Also the innovation increase the efficiency and lower the cost of a bank.

Thirdly, they have to be comprehensive and integrative. One important difference of Chinese banks from the other banks from the world is they treat services differently. For example, banks usually only deal with traditional services such as saving and withdrawing money. Stocks are offered by security companies, insurance companies and trust companies are usually not connected and have their own services.

Comprehensive operations can lower the cost and improve the management efficiency. But this will require a higher management and risk control levels.

Integration has a similar effect to the company. It increases banks' efficiency by improving the processes with customers.

5.3 Forecasts and expectations.

With the step-out strategy, Chinese commercial banks are now developing rationally and with more confidence. They have increased in the rankings and gained competitive power. But how long this trend will last depends on their globalization process and the way they develop.

World class commercial banks should have a high degree of globalization. If we look at the top 80 banks in the world by the year 2002, overseas services of American and Canadian banks occupied 33.6% of their total services. European banks have a value of 44.9%, which is the highest over the world. Japanese commercial banks also have 15.3% services provided overseas. Chinese commercial banks have the lowest rate of less than 8%. So they should learn from the good experience, develop a globalization strategy with a specified plan and Chinese characteristics of targeting the customers and market needs, by being creative and providing innovative financial products. All these will help their expansion.

With the current situation of Chinese financial markets, the efficient use of capital and the low cost will be the key factors of banks international competitive power. So, improving the ability of asset valuation, resource allocation and comprehensive operations can be important for the sustainability development of banks.

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