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Foreign banks—can Chinese banks compete?

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China finally joined the World Trade Organization in December 2001, after 14 years of negotiation. Accession makes Chinese enterprises subject to the authority of international rules and competition, including banks. At the same time, China will be open to the risks and uncertainties of international financial markets. The domestic financial structure and banking sector will change dramatically and become stronger and more stable in the long term.

China has committed to a four-step process of reform for the banking sector on accession to the WTO. Foreign-funded banks will be permitted to provide international financial services to foreign companies in China. One year after the accession, foreign-funded banks will be permitted to provide international financial services to Chinese companies and social agencies. After two years, foreign-funded banks can administer renminbi (RMB) financial services to institutions. Finally, five years after accession, foreign-funded banks will be permitted to supply individual financial services to the Chinese population.

After China entered the WTO, Nanjing Ericsson acted in an interesting fashion. In March 2002, the Nanjing Ericsson Company repaid all its loans, worth about US\$2 billion, to their Chinese lenders, the Bank of Communications, the Industrial and Commercial Bank of China and the Bank of China and reborrowed the amount from Citibank. Clearly, the level of competition between foreign and Chinese banks had become more significant.

The Chinese government has undertaken reform in the banking sector in an effort to improve the financial sector as a whole. The People's Bank of China

made five commitments to foreign financial institutions to ensure entry into the Chinese market (Dai 2001). First, China will revoke existing regulations stating that foreign-funded financial institutions in China were to be approved by the State Council. Foreign-funded institutions will then be able to establish commercial institutions in any city. Second, China will remove controls over targets for foreign exchange services provided by foreign-funded financial institutions. Third, current business scale limitations, concerning the regulations foreign firms face when being admitted into the RMB, will be removed. However, foreign financial institutions must follow three requirements to operate a RMB business—businesses must have been operating for over three years, have made a profit for two consecutive years and have met requirements set by the People's Bank of China. Fourth, China will abandon control over the establishment of joint venture banks or joint venture financial firms. Foreign financial firms will be able to select any Chinese company as their partner. Finally, China will increase the business scope for RMB operations by foreign financial companies and make RMB business services more available in regional areas.

The deadline for the five-year commitment approaches—foreign-funded banks have been guaranteed equal treatment with Chinese banks by 2006. In light of this, an assessment of the banking sector is particularly timely.

Current circumstances for Chinese banks

After twenty years of banking reforms, the main banking infrastructure in China is operational. Competition between Chinese and foreign-funded banks has become fierce. As the deadline for the banking sector to admit foreign competitors approaches, the growing pressure on Chinese banks is becoming more evident.

The market structure is divided into four parts—assets structure, deposits structure, loans structure and profits structure. Three important changes to the structure of banking assets have occurred during the past decade (Table 10.1). The market-share percentage of the 'big-four' banks has been reduced from 86 per cent in 1995 to 73 per cent in 2003. The 'big-four' banks still dominate the assets structure of the banking sector in China. Non-state commercial banks, such as the Bank of Communications, have grown fast over the last ten years, from RMB 484.6 billion in 1995 to RMB 4,002 billion in 2003—an increase of eight times. Finally, foreign-funded banks in China have also grown steadily in the past decade, from RMB 158.8 billion in 1995 to RMB 400.1 billion in 2003.

Similar changes in the deposits structure have also taken place (Table 10.2). Three important changes have taken place in the banking deposits structure over

Table 10.1 Assets structure of major banks (100 million RMB)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
The Industrial and Commercial Bank of China	19,357.2	22,565.9	24,901.3	32,387.0	35,398.7	39,737.7	43,180.7	47,342.4	52,399.6
The Agricultural Bank of China	9,772.5	11,742.3	13,423.9	20,224.0	22,758.4	21,848.9	25,279.9	29,765.7	34,940.2
Bank of China	5,710.2	6,477.6	7,292.6	7,437.9	9,102.7	26,851.1	25,966.4	28,500.5	31,402.1
Construction Bank of China	9,523.0	11,482.5	13,756.0	19,236.0	22,010.7	25,317.0	27,649.6	30,832.0	35,542.8
Total	44,362.9	52,268.3	59,373.8	79,284.9	89,270.5	113,754.7	122,076.6	136,440.5	154,284.7
Bank of Communications	2,104.6	2,500.78	3,084.5	4,839.2	5,380.5	6,281.8	6,690.7	7,668.7	9,504.4
CITIC Industrial Bank	350.4	559.0	741.0	1,336.1	1,573.3	2,352.9	3,004.0	3,351.6	4,198.0
China Everbright Bank	211.7	432.5	413.6	747.23	1,678.9	2,042.0	2,654.1	3,192.2	3,944.2
Hua Xia Bank	92.5	196.2	257.8	498.7	611.3	951.1	1,366.4	1,781.5	2,468.3
Guangdong Development Bank	513.5	708.3	505.2	1,069.2	1,219.0	1,487.4	1,912.0	2,191.8	3,017.3
Shenzhen Development Bank	270.3	379.3	204.2	390.1	458.7	660.1	1,201.3	1,661.7	1,928.5
Shenzhen Merchants Bank	564.9	874.0	670.0	1,509.1	1,802.8	2,195.1	2,663.2	3,716.6	5,038.9
Pudong Development Bank	386.8	641.6	641.1	849.3	1,032.1	1,297.4	1,736.9	2,793.0	3,710.6
Fujian Industrial Bank	351.6	258.1	215.3	355.8	491.8	856.1	1,248.4	1,910.6	2,600.0
Mingsheng Bank		68.1	150.0	252.4	363.9	697.2	1,389.0	2,466.6	3,610.6
Total	4,846.1	6,618.0	6,882.7	11,847.0	14,612.4	18,821.0	23,865.8	30,734.3	40,021.0
Total of City Commercial banks	646.5	2,141.9	2,744.8	3,723.1	4,516.8	6,998.0	8,730.4	11,661.4	14,653.7
Foreign banks	1,588.6	2,483.4	3,147.4	2,836.9	2,638.6	2,857.7	3,749.9	3,210.6	4,001.6
Total assets	51,444.1	63,511.6	72,148.7	97,691.9	111,038.3	142,431.3	158,422.8	170,578.4	212,961.0

Sources: Jiao, J., 2002. *Study on International Competitiveness of China's Banking Industry*, Chinese Modern Economic Publishing House, Beijing:69-77. Association of China's Finance and Banking, 2002-04. *Almanac of China's Finance and Banking (2002-2004)*, Chinese Financial Publishing House, Beijing.

the past decade. The market-share percentage of the 'big-four' banks has been reduced from 89 per cent in 1995 to 82 per cent in 2003. The 'big-four' banks still dominate the deposits structure of the banking sector, dropping only 7 per cent—small when compared to the assets structure. Non-state commercial banks grew rapidly over the past ten years, from RMB 348 billion in 1995 to RMB 2,805 billion in 2003—increasing over eight times. Foreign-funded banks in China also grew steadily during the past decade, from RMB 26 billion in 1995 to RMB 72.7 billion in 2003.

Similar changes have occurred in the loans structure (Table 10.3). At least three important changes have occurred in the banking loans structure over the past decade. The market-share percentage of the 'big-four' banks has been reduced from 90 per cent in 1995 to 81 per cent in 2003. However, the 'big-four' banks still dominate the loans structure of the banking sector. Second, non-state commercial banks grew rapidly over the last ten years, from RMB 231.1 billion in 1995 to RMB 1,964.3 billion in 2003—an increase of over eight times. Finally, foreign-funded banks in China grew steadily over the past decade, from RMB 105.8 billion in 1995 to RMB 193.7 billion in 2003. It increased only 1.8 times during the period.

At least three changes have occurred in the structure of banking profits over the past decade (Table 10.4). The percentage of the 'big-four' banks is not considered stable. The 'big-four' banks did not dominate the profits structure in 2003, taking in only 41 per cent of the total. The profits of non-state commercial banks have increased over the last ten years, from RMB 7 billion in 1995 to RMB 16 billion in 2003—over 50 per cent of the total market. Finally, the profits of foreign-funded banks in China has remained stable during the past decade, from RMB 2.1 billion in 1997 to RMB 1.8 billion in 2003—less than 10 per cent of the total market.

The four state commercial banks occupy an important place in the banking sector. Two indices, the concentration ratio CR_n and the Herfindahl index H are used to determine whether a monopoly exists.

The concentration ratio of the industry is used as an indicator of the relative size of firms in relation to the industry as a whole (Table 10.5). The four firm concentration ratio is commonly used, where $n=4$, the 'big-four'

$$CR_n = \frac{\sum_{i=1}^n X_i}{\sum_{i=1}^N X_i}$$

Using J-S Bain Analysis, the market structure is divided into six categories. The 'big-four' banks have retained a monopoly with a CR_4 above 75 per cent until

Table 10.2 Deposits structure of major banks (100 million RMB)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
The Industrial and Commercial Bank of China	14,443.0	17,974.6	21,611.7	25,032.1	28,335.1	32,485.2	35,804.7	40,569.0	456,81.6
The Agricultural Bank of China	6,939.3	8,950.1	11,189.4	13,348.6	15,492.1	18,089.0	20,914.1	24,796.9	29,972.8
Bank of China	3,904.2	4,864.3	5,864.3	7,308.8	8,652.2	16,854.8	17,988.6	20,830.5	24,271.1
Construction Bank of China	7588.9	10333.3	12555.2	14689.4	16845.5	20102.8	22,655.6	25,996.5	29,712.8
Total	32,875.3	42,122.3	51,220.5	60,378.8	69,325.0	875,31.8	97,363.1	112,192.2	129,638.5
Bank of Communications	1,824.2	2,277.4	2,698.3	3014.6	3,385.1	3,169.7	3,673.1	4,547.7	5,875.9
CITIC Industrial Bank	337.1	540.4	692.8	790.5	938.2	1,275.5	2,266.9	2,648.7	3,442.4
China Everbright Bank	133.8	248.8	300.7	411.6	565.6	1,338.6	1,790.5	2,342.7	2,995.5
Hua Xia Bank	55.6	140.7	239.2	339.3	442.1	686.0	973.2	1,328.1	1,869.8
Guangdong Development Bank	298.0	362.0	475.5	614.8	698.1	988.7	1,361.8	1,496.2	2,050.4
Shenzhen Development Bank	107.4	164.1	182.1	249.5	308.8	447.3	738.9	929.9	1,120.6
Shenzhen Merchants Bank	357.4	521.0	500.0	673.3	904.7	1562.0	2018.7	2,816.1	37,06.4
Pudong Development Bank	228.3	371.8	522.5	632.7	722.7	984.1	1348.4	2,078.0	2641.8
Fujian Industrial Bank	138.7	168.8	170.3	224.2	286.1	475.5	777.5	1,277.2	1,810.3
Mingsheng Bank	--	35.9	123.5	160.8	260.8	478.2	1020.9	1,734.5	2537.33
Total	3,480.4	4,830.8	5,904.9	7,111.3	8,512.2	11,405.4	15,969.9	21,199.1	28,050.4
Total of City Commercial banks	506.2	1,470.6	2,536.7	3,629.5	4,387.4	--	6,816.7	8,988.24	11,747.6
Foreign banks	260.6	323.7	371.8	373.1	431.6	482.5	552.5	727.6	--
Total deposits	37,122.5	48,47.4	60,034.0	71,492.7	82,656.2	98,937.3	120,702.2	143,107.1	169,436.5

Sources: Jiao, J., 2002. *Study on International Competitiveness of China's Banking Industry*, Chinese Modern Economic Publishing House, Beijing; 69-77. Association of China's Finance and Banking, 2002-04. *Almanac of China's Finance and Banking (2002-2004)*, Chinese Financial Publishing House, Beijing.

Table 10.3 Loans structure of major banks (100 million RMB)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
The Industrial and Commercial									
Bank of China	14,054.1	16,331.3	19,092.8	21,705.5	23,334.9	24,135.9	26,594.7	29,578.4	33,469.2
The Agricultural Bank of China	6,553.8	7,712.9	9,809.2	13,666.1	15,527.5	14,843.6	16,461.8	19,129.6	22,683.9
Bank of China	4,179.3	4,751.5	5,630.0	6,503.8	7,318.2	115,01.5	12,461.9	14,023.1	16,873.3
Construction Bank of China	6,135.3	7,457.2	10,291.7	11,735.6	11,275.6	13,863.9	15,059.1	17,663.9	21,221.3
Total	30,922.5	36,252.9	44,823.7	53,611.0	57,456.2	64,344.8	70,577.4	80,394.9	94,247.8
Bank of Communications	1,210.9	1,486.6	1,824.21	2,148.7	2,435.4	2,633.7	29,98.4	3,580.9	4,669.1
CITIC Industrial Bank	154.4	244.0	374.5	459.6	607.9	1,207.4	1,607.0	1,393.6	1,871.3
China Everbright Bank	66.4	159.9	235.3	297.0	366.8	698.5	996.1	1,366.6	1,971.5
Hua Xia Bank	39.8	83.7	125.4	201.4	267.6	454.5	622.3	7,98.4	1,223.0
Guangdong Development Bank	220.2	266.1	310.7	413.3	500.9	710.7	1,022.9	857.8	1388.1
Shenzhen Development Bank	76.9	102.8	128.7	177.9	210.9	231.4	415.2	537.3	862.6
Shenzhen Merchants Bank	285.2	414.0	366.9	493.7	618.6	766.1	989.1	1,493.0	2,301.7
Pudong Development Bank	154.8	231.2	341.8	415.6	479.9	591.7	852.4	1,358.5	2,204.4
Fujian Industrial Bank	102.52	116.7	121.7	150.4	210.0	302.7	491.7	901.8	1,390.0
Mingsheng Bank		19.7	50.4	98.9	150.3	301.1	526.7	998.5	1,761.5
Total	2,311.0	3,124.7	3,879.4	4,856.3	5,848.23	7,898.0	10,524.7	13,286.54	19,643.3
Total of City Commercial banks	202.2	779.8	1,491.3	2,193.0	2,704.0	3,481.0	4,257.7	5,924.8	7,743.7
Foreign banks	1,058.3	1,612.7	2,280.0	2,162.2	1,782.0	1,548.4	1,538.5	1,525.5	1,936.8
Total loans	34,493.9	41,770.1	52,474.5	62,822.5	67,790.4	77,272.2	86,898.3	101,131.7	123,571.5

Sources: Jiao, J., 2002. *Study on International Competitiveness of China's Banking Industry*, Chinese Modern Economic Publishing House, Beijing; 69-77. Association of China's Finance and Banking, 2002-04. *Almanac of China's Finance and Banking (2002-2004)*, Chinese Financial Publishing House, Beijing.

Table 10.4 Profits structure of major banks (100 million RMB)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
The Industrial and Commercial Bank of China	46.7	58.1	30.5	34.5	41.3	173.6	148.1	62.2	21.1
The Agricultural Bank of China	19.4	21.0	5.3	-9.1	-3.6	2.9	11.5	21.2	19.4
Bank of China	47.0	52.1	39.4	35.2	29.0	28.0	31.1	110.6	70.4
Construction Bank of China	61.7	48.3	18.8	16.4	49.6	84.8	51.9	43.4	4.5
Total	174.8	179.6	93.9	86.2	119.9	289.4	242.6	237.3	115.4
Bank of Communications	37.7	36.2	37.7	26.7	26.9	26.7	25.6	15.9	1.7
CITIC Industrial Bank	6.8	10.6	13.7	20.0	11.4	14.5	15.7	22.4	24.5
China Everbright Bank	3.1	7.0	11.0	13.0	6.8	3.7	4.2	6.1	8.2
Hua Xia Bank		4.4	5.3	4.9	5.1	7.5	9.2	11.5	13.8
Guangdong Development Bank	4.2	1.7	2.8	2.7	2.2	3.6	4.3	4.6	5.3
Shenzhen Development Bank	4.4	7.8	8.6	8.1	6.0	5.0	5.6	5.1	3.5
Shenzhen Merchants Bank	11.5	18.7	19.4	20.0	15.2	12.0	21.1	25.7	34.5
Pudong Development Bank		12.5	13.3	10.4	11.8	9.9	14.4	18.7	23.4
Fujian Industrial Bank	2.1	2.7	3.5	5.5	4.4	4.6	7.3	9.2	16.3
Mingsheng Bank		0.1	3.9	2.5	3.6	3.7	9.0	12.2	19.4
Total	69.7	101.8	119.2	113.9	93.3	91.2	116.3	131.4	150.6
Total of City Commercial banks			21.2	17.8	-12.9	0.6	24.1	38.0	54.2
Foreign banks			234.3	217.9	213.2		16.3	15.1	18.5
Total profits	244.5	281.4				381.2	399.4	421.8	338.6

Sources: Jiao, J., 2002. *Study on International Competitiveness of China's Banking Industry*, Chinese Modern Economic Publishing House, Beijing:69-77. Association of China's Finance and Banking, 2002-04. *Almanac of China's Finance and Banking (2002-2004)*, Chinese Financial Publishing House, Beijing.

Table 10.5 'Big-four' concentration ratio

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Assets	86.2	82.3	82.3	81.2	80.4	79.9	77.1	79.9	72.5
Deposits	88.6	86.4	85.3	84.5	83.9	88.5	80.7	78.4	76.5
Loans	89.6	86.8	85.4	85.3	84.8	83.3	81.2	79.5	76.3
Profits	71.3	63.8	40.1	39.6	56.2	75.9	60.8	56.3	34.1

Sources: Jiao, J., 2002. *Study on International Competitiveness of China's Banking Industry*, Chinese Modern Economic Publishing House, Beijing:69–77. Association of China's Finance and Banking, 2002–04. *Almanac of China's Finance and Banking (2002–2004)*, Chinese Financial Publishing House, Beijing.

2002, classified as oligopoly one (Table 10.6). However, the monopoly has gradually decreased since 1995, from an average of 85 per cent to 75 per cent. Moreover, the monopoly degree of deposits and loans, around 76 per cent, is starting to shift to an oligopoly of two, while the monopoly degree of assets is already oligopoly two. The 'four concentration ratio' for profits is around 34 per cent, suggesting Chinese banks are ready to face international competition.

The Herfindahl index is also a measure of the size of firms in relation to the industry and an indicator of the level of competition among banks. It is defined as the sum of the squares of the market shares of each individual firm.

$$H = \sum_{i=1}^n (X_i/T)^2$$

The United States uses the Herfindahl index to determine whether mergers are equitable—increases of over 100 points generally provoke scrutiny, although it varies between cases (Table 10.7). The Department of Justice considers Herfindahl indices between 1000 and 1800 to be moderately concentrated and indices above 1800 to be concentrated. As the market concentration increases, competition and efficiency decrease and the chance of collusion and monopoly increase.

In 2003, the H index for assets, loans and profits was below 1800 points, which suggests the 'big-four' banks are losing their monopoly (Table 10.7). However, the H index for deposits is still above 1800 points, suggesting concentration. In 1995, the H index for profits was already showing moderate levels of concentration.

The degree of monopoly by the 'big-four' banks has gradually decreased over the past ten years for assets, loans and profits, while deposits still demonstrate a monopoly. The monopoly of deposits may be explained by the wide spread of bank branches across the country. High operation costs incurred by bank branches may explain the decreasing monopoly of profits.

Table 10.6 **Market structure**

Market structure	CR4
Oligopoly 1	$75 \leq CR4$
Oligopoly 2	$65 \leq CR4 \leq 75$
Oligopoly 3	$50 \leq CR4 \leq 65$
Oligopoly 4	$35 \leq CR4 \leq 50$
Oligopoly 5	$30 \leq CR4 \leq 35$
Competition	$CR4 \leq 30$

Source: Jiao, J., 2002. *Study on International Competitiveness of China's Banking Industry*, Chinese Modern Economic Publishing House, Beijing:69–77.

Current circumstances for foreign-funded banks

There was no significant change in the number of foreign-funded banks in China between 1999 and 2003 (Tables 10.8 and 10.9). Foreign-funded bank branches totalled 156 at the end of 1999 and 157 at the end of 2003. Japanese banks closed 28 branches in 1999 and only 20 branches at the end of 2003. South Korean banks opened 5 new branches in the period from the end of 1999 to the end of 2003. In the current climate, the location of foreign-funded banks became more balanced. The number of foreign-bank branches across China is not expected to dramatically increase in the foreseeable future.

Current performance of Chinese banks

Chinese banks have many desirable features—good sales networks, a wide distribution of branches across the country, the 'big-four' banks are ranked among the largest 100 banks in the world, and have significant customer numbers, extensive local knowledge and government support. Flourishing banks, such as Mingsheng and CITIC Industrial Bank, are considered serious competitors to foreign-funded banks.

Less desirable characteristics include poor management, underdeveloped human resources and service skills, unclear ownership structures, the non-profit orientation and a tendency to be overly reliant on government support.

Foreign-funded banks have several advantages—profit-orientated attitude, the low level of non-performing loans (0.67 per cent (Liang 2003)), they have better understanding of financial innovations and enjoy important connections with international markets, highly-qualified staff, and incentive-based salaries. As such, foreign-funded banks are able to attract Chinese staff in an attempt to offset the lack of local knowledge. Most of the large foreign institutions are global banks.

Table 10.7 Herfindahl index

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Assets	2275	2083	2059	2028	1952	1743	1639	1773	1466
Deposits	2421	2288	2248	2220	2214	2137	2116	2263	2587
Loans	2508	2351	2192	2094	2142	1930	1850	1771	1625
Profits	1703	1385	1047	1058	1444	2716	1786	1253	1075

Source: Jiao, J., 2002. *Study on International Competitiveness of China's Banking Industry*, Chinese Modern Economic Publishing House, Beijing:69–77.

Foreign-funded banks have a high potential to succeed against and compete with Chinese banks, yet there are several potential weaknesses—limited local knowledge, a small customer base, a limited number of branches across China, and the fact that they remain subject to the domestic clearing system.

Since China's accession to the WTO, foreign-funded banks have been able to do the same business as Chinese banks, with the ability to set up branches like Chinese banks without restriction and provide financial services to Chinese companies and individuals.

Anderson (2005) proposed six criteria to judge improvements in the banking sector

- size of the non-performing loans
- quality of internal controls
- ownership and privatisation
- deregulation and structural change
- level of government interference
- quality of macroeconomic management.

The size of non-performing loans is important because bad loans damage the banking system by directly reducing the bank's profitability and cash flows. Non-performing loans also divert new real resources to rolling-over bad asset exposure. Banks can become weakened and more sensitive to shocks in the economy.

After the economic bubble burst in 1996–97, the non-performing loan ratio for financial systems was approximately 55 per cent to 65 per cent. The current non-performing loan ratio is approximately 25 per cent to 30 per cent—still high but decreasing. The decrease in the ratio is due to government reform and improved performance of flows. Moreover, the quality of official non-performing loan data is becoming more accurate with the adoption of a standard five-tier classification system in 2001.

Problems in the balance sheet were previously hidden with false reporting of non-performing loans.

Table 10.8 Regional distribution of foreign-funded bank branches in China, end of 1999

	Shanghai	Beijing	Shenzhen	Guangzhou	Tianjin	Xiamen	Dalian	Other regions	Total
Hong Kong	4	2	9	4	1	3	3	10	36
Japan	9	3	3	1	3	0	6	3	28
France	5	1	3	3	3	1	0	1	17
United States	4	4	1	2	1	1	0	0	13
Singapore	4	1	1	1	1	2	0	1	11
South Korea	2	1	0	0	4	0	1	0	8
Germany	5	1	1	1	0	0	0	0	8
United Kingdom	1	1	1	0	1	1	0	3	8
Belgium	1	0	1	1	0	0	0	0	3
Thailand	1	0	1	0	0	1	0	2	5
Netherlands	3	1	2	0	0	1	0	0	7
Other countries	7	1	0	2	0	1	0	1	12
Total	46	16	23	15	14	11	10	21	156

Source: Association of China's Finance and Banking, 2000. *Almanac of China's Finance and Banking (2002–2004)*, Chinese Financial Publishing House, Beijing.

Table 10.9 Regional distribution of foreign-funded bank branches in China, end of 2003

	Shanghai	Beijing	Shenzhen	Guangzhou	Tianjin	Xiamen	Dalian	Other regions	Total
Hong Kong	4	3	8	4	1	3	3	12	38
Japan	4	3	3	1	3		4	2	20
France	5	2	2	3	3	1	0	1	17
United States	4	4	1	2	2	1	0	0	14
Singapore	3	2	1	1	1	2	0	1	11
South Korea	5	2	0	0	4	0	1	1	13
Germany	5	1	0	1	0	0	0	0	7
United Kingdom	2	1	1	0	1	1	0	2	8
Belgium	2	0	1	1	0	0	0	1	5
Thailand	1	0	1	0	0	1	0	2	5
Netherlands	3	1	1	0	0	0	0	0	5
Other countries	7	3	0	2	0	0	0	2	14
Total	45	22	19	15	15	9	8	24	157

Source: Association of China's Finance and Banking, 2004. *Almanac of China's Finance and Banking (2002-2004)*, Chinese Financial Publishing House, Beijing.

Internal governance and supervision controls have improved with cooperation between the government and banks. Restructuring, raising controls and procedures for regulatory agencies, the adoption of international accounting procedures, risk management practices, and better trained employees also contributed to this.

Questions over the ownership structure of banks still remain. This is a delicate issue because managers of the 'big-four' banks have appointed civil servants with close attachments to the central and local governments. As a result, it is unclear where the real control of banks lies.

There have been two major structural changes. Liberalisation has taken place since the early 1990s; however, with recent support by the government for the consolidation of the financial sector, the economy is stronger and more stable than in the post-bubble period.

The share of the state in total lending and government interference has fallen over the past decade. This is due to both the rising share of non-state lending firms and the improving quality of state borrowers.

Anderson (2005) believes that the overall macroeconomic environment is optimistic. Authorities were able to react efficiently during the period 2002–04, which was characterised by rapid lending and overheated growth. Interest rates remain rigidly fixed at low levels but don't indicate that authorities are unable to make changes. The People's Bank of China is focused on setting the quantity of money rather than price. This focus has advantages because they have succeeded

Figure 10.1 An index of progress in China's banking system

Source: Anderson, J., 2005. 'Which way out for the banking system?', *Asian Economic Perspectives*, UBS Investment Research, June:16.

Table 10.10 **Comparison between Chinese and international banks, 1998**

	Tier one capital	Staff	Per capita profit	Per capita tier one capital	Per capita assets
China					
Bank of China	14,712	202,147	2.1	72.8	1,479.2
The Industrial and Commercial Bank of China	22,213	576,230	0.5	39.2	689.7
The Agricultural Bank of China	4,802	538,800	0.9	8.9	352.8
Construction Bank of China	5,988	386,000	3.1	15.5	526.2
France					
Credit Agricole Group	25,930	86,100	43.7	301.2	5,308.2
Banque Nationale de Paris	12,824	52,404	33.2	244.7	7,233.1
Societe Generale	12,521	58,600	34.3	213.7	7,637.3
Credit Mutuel	10,737	45,300	26.2	237.0	6,323.6
Germany					
Deutsche Bank	18,680	75,306	62.6	248.0	9,727.4
Dresdner Bank	13,042	48,948	31.9	266.5	8,728.9
Hypo Vereinsbank	11,853	25,146	108.9	471.4	13,409.6
Commerzbank	11,760	27,912	51.9	421.3	13,662.9
United States					
Citigroup	41,889	184,914	50.1	226.5	3,616.0
Bank America Corporation	36,877	170,975	47.1	215.7	3,612.7
Chase Manhattan Corporation	24,121	72,683	82.3	331.9	5,033.8
Bank One Corporation	19,654	88,628	50.4	221.8	2,950.3
United Kingdom					
HSBC Holdings	29,352	132,285	49.8	221.9	3,663.7
Barclays Bank	13,495	78,600	40.6	171.7	4,495.8
National Bank	13,389	64,400	55.3	270.9	4,804.7
Royal Bank of Scotland	12,111	77,200	65.0	156.9	3,109.7

Source: Huang, P. and Wang, G., 2003. *Institutional Reforms and Approach Options of the State-Owned Banks*, Economic Science Publishing House, Beijing:260.

Table 10.11 Comparison between Chinese and international banks, 2003

	Tier one capital	Staff	Per capita profit	Per capita tier one capital	Per capita assets
China					
Bank of China	21,916	192,468	8.7	1,13.9	2,255.90
The Industrial and Commercial Bank of China	21,530	405,558	2.1	53.1	1,423.0
The Agricultural Bank of China	16,435	--	--	--	--
Construction Bank of China	12,955	306,809	1.7	42.2	1,214.1
France					
Credit Agricole Group	35,660	955,37	39.7	373.3	6,375.1
Banque Nationale de Paris	24,119	87,685	64	275.1	8,495.0
Societe Generale	16,000	88,278	29.6	181.3	5,954.5
Credit Mutuel	13,156	54,300	37.6	242.3	6,710.7
Germany					
Deutsche Bank	23,848	77,442	48.1	307.9	10,269.0
Dresdner Bank	20,056	65,926	-13.4	304.2	10,993.9
Hypo Vereinsbank	12,259	36,566	-10.7	335.3	12,106.2
Commerzbank	9,950	9,605	23.8	1,036.0	37,262.3
United States					
Citigroup	59,012	250,000	91.1	236.0	4,388.8
Bank America Corporation	43,012	133,944	97.0	321.1	4,930.8
Chase Manhattan Corporation	37,570	94,335	26.7	398.3	8,043.7
Bank One Corporation	23,918	73,685	64.6	324.6	3,764.4
United Kingdom					
HSBC Holdings	38,949	184,406	52.3	211.2	4,177.2
Barclays Bank	27,651	111,800	68.7	247.3	5,808.6
National Bank	23,836	60,000	78.1	397.3	8,536.1
Royal Bank of Scotland	22,895	74,700	69.2	306.5	8,540.1

Source: Wei, C. and Zhu, F., 2005. *Commercial Banking Competitiveness*, China Financial Publishing House, Beijing:7-9.

reigning in liquidity by lowering base money growth in recent periods. Moreover, administrative controls have been successful in the past few years. Since 2004, the state has lifted step-by-step controls on bank lending rates.

Conclusion

Between 1998 and 2003, for the Chinese 'big-four' banks (Tables 10.10 and 10.11)

- tier one capital increased
- staff numbers gradually decreased
- per capita profit improved from 1998 to 2003 for the Bank of Communications,

and the Industrial and Commercial Bank of China but not for the Construction Bank of China

- per capita tier one capital and per capita assets increased.

However, there were several problems

- per capita profit was low compared to international standards
- per capita assets were extremely low compared to the international standard
- the 'big-four' banks were overstaffed.

The Chinese banking sector has undeniably become more competitive in the last decade, in loans, deposits, assets and profits. However, while Chinese banks are becoming stronger and more stable they have some distance to go to match international standards. There are three objectives for Chinese banks—bank balance sheets must be cleaned up, the Chinese government should reshape the ownership structure of banks and, finally, the government should further liberalise the financial sector. As the deadline approaches in 2006, we expect that dramatic changes in the market players or structure of the Chinese banking sector are not likely to occur.

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