Research on the Challenges and Sustainable Development Strategies of Community Banks in China

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Abstract: *With the rapid development of information technology and the Internet, online financial services are fast, equal, and flexible, which bring a lot of challenges to commercial banks, especially the subsidiary community banks. This thesis first clarifies related research at home and abroad and further expounds on the development status and existing problems of the community banks. Then it proposes to improve the supervision system, strengthen technical support and talent reserve, and promote the development of online finance and credit reporting, in order to increase the core competitiveness of community banks in China.*

Keywords: Community bank, Internet finance, Sustainable development.

1. Literature Reviews

Currently, western scholars have done a lot of research on community banks, and a mature and comprehensive theoretical system has been formed. But community banks in China came relatively late, which is not yet mature, so the research on community banks in China only emerged at the beginning of the 21st century. Moreover, most Chinese scholars' points come from western theories, and they mainly focus on the financial institutions and small or medium-sized commercial banks in rural areas. So, there is a research gap in the theoretical level of community banks between China and Western countries. In general, the research on community banks can be divided into the following two categories:

One is to study the definition and function of community banks. As for the definition of community banks, from the capital scale point of view, Barbara Gronauer (2016) pointed out that banks with an average capital scale of less than 10 billion US dollars can be called community banks. According to the business model of community banks, Deyoung (2004) and Shusong Ba (2002) both suggested that community banks are small and medium-sized banks, which are independently established and operated based on the marketization laws, with individuals and small and micro enterprises (SME) as the target customers. The coverage of such banks is relatively limited, and their equity is usually not circulated in the open capital market. In terms of characteristics and functions of community banks, Basset (2011) pointed out that the growth rate of deposits and loans of community banks is taking the leading position in the US. In the meanwhile, Joseph Vella (2012) emphasized that the advantages of community banks are reflected in personalized service, localized credit decision-making and ownership. Due to the flexibility of the system and business model, Martin Fraring (2013) believes that community banks have a competitive advantage in providing relational credit financing for SME. Ying He (2004) emphasized that community banks can not only analyze financial statements, but also comprehensively analyze the financial status of families in a specific community. Michael

Gibson (2016) emphasized that community banks act as the capital circulation channels of community finance, which can improve the community functions.

The other is to explore the sustainable development pattern for community banks. Brickley (2003) believes that the moral hazard caused by the principal-agent of community banks could be partly reduced by ownership incentives. Yuechun Wen (2006) proposed that community banks should be based on specific areas to provide customized financial products for residents and SME in the community. Xiuqin Lin and Linhui Song (2010) pointed out that community banks should continuously launch new products and strengthen service innovation to increase economies of scale. Based on the franchise model of community banks in Australia, Ningwei Cai (2015) believed that a win-win situation between the community and the bank can be achieved by charging commissions. Lixue Yin (2016) pointed out that the best development strategy for community banks in China is to "prosper against the too-big-to-fail giants." Huan Wang (2017) and Tingting Bao (2019) stressed that community banks should build a new development model of networking in line with the development of Internet finance.

Based on the existing research, it is concluded that the advantages of community banks are mainly reflected in convenience and flexibility. As a bank of a relatively small scale, community banks can meet the basic financial needs of individuals and SME and serve the community timely and effectively, which plays an essential role in the development of the regional economy. To achieve sustainable and long-term development, it is necessary for community banks to adjust their business strategy according to local conditions, continually innovate new business models and keep pace with the times.

2. The Current Situation of Community Banks in China

Currently, interest rate liberalization and online finance have

made a significant impact on traditional banking. Commercial banks are growing more “convenient, service-oriented and intelligent” with one-stop service to secure their places in the market. China Banking Regulatory Commission clearly defined at the end of 2013 that “community bank is one of the special sub-branches that serve community residents and small and micro enterprises.” Community banks mainly differ from other banks in their simple organizational structure and relatively single business. As the economy and individual wealth flourish, the potential of community finance becomes increasingly prominent, and community banks have become a necessity for commercial bank transformation. Therefore, many small and medium-sized financial institutions in China drew on foreign experience and made many beneficial attempts to develop commercial banks. For example, Shanghai Rural Commercial Bank first set up “financial convenience stores” in 2007. After that, China Merchants Bank of China (CMBC), China Industrial Bank, Ping An Bank and China Guangfa Bank have also launched pilot programs and 24-hour remote manual service since 2013, which laid a solid foundation for the generalization of community banks. For the past ten years, the community bank has expanded considerably in China since its birth. Its number has sharply increased from 141 in 2013 to 6011 in 2018 and has exceeded 10,000 throughout major cities in China.

According to banking nature, joint-equity banks constitute the majority of community banks (accounting for more than 60%). All the commercial banks have set up joint-equity community banks apart from China Zheshang Bank, among which CMBC ranks first with 1,324 joint-equity community banks, followed by Bank of Beijing (226 commercial banks) and Guilin Bank (131 commercial banks). Currently, commercial banks in China are generally divided into three levels, namely headquarters, sub-branches and community banks, while commercial banks can be divided into city commercial banks, rural credit cooperatives (including rural commercial banks and rural cooperative banks) and village banks. Community banks are generally simple banking outlets that do not have the authority for corporate business and high-level personal business. At the end of 2018, the asset of all community banks had amounted to 64.5 trillion Chinese yuan, accounting for approximately 25% of the total asset of all banking institutions. Community banks also played an active role in providing loans to SME, whose credit lines are less than 5 million Chinese yuan.

3. Challenges Faced by the Community Banks in China

3.1 Simple Business Mode

Community banks continue to adopt the traditional laying mode of commercial banks and are featured with longer business hours and shorter distances to communities. But they are deficient in-service features, product designs and service diversification, and also weak in product and service

innovation, resulting in serious homogenization, inefficient operation and high operating costs. Worse still, some commercial banks lack comprehensive market research and strategic support. Taking China Everbright Bank as an example, it innovated mechanically and finally got thankless results. Its exclusive “community-specific financial product” only increased the interest rate by 1.5% and had no other obvious difference with standard financial products. As a result, it failed to capture the market rapidly. The residents in different communities differ in ages, educational backgrounds, incomes and jobs. But community banks have not developed various personalized products and services to appeal to more customers and increase their loyalty. So, currently, community banks in China are still not well integrated into communities.

3.2 Inaccurate Positioning and Inefficient Management

Many commercial banks in China have provided convenient and specific services to communities and small and medium enterprises since 2017. Still, their operating modes and procedures are similar to sub-branches and bring little effect. For example, loan approval rights are mainly held by superior branches, which leads to a more complicated approval process and lower approval efficiency. In addition, it is noteworthy that some commercial banks carry out inefficient management on remote community banks. They do not fully comply with commercial principles with the compliant operation and market occupancy. For example, some blindly expand their asset size with “rigid payment” promise, and transform the economy from substantial to fictitious, coupled with problems such as maturity mismatch, leverage superposition, and out-of-scope business.

3.3 Insufficient Technical Support and Talent Reserve

Many community banks make light of product innovation and business development. They only provide daily consumption services like withhold and remit social security and pension, issue cards, withdraw cash, and repay credit cards. To provide the customers with efficient, convenient and personalized products and services, community banks should update proprietary technology, capacity in microfinance, and talent reserve in terms of product design, business process, risk control and assessment. Therefore, it is necessary for community banks to standardize services and build a strong talent pool. But compared to large commercial banks, community banks have different customers and products, which means the traditional management mode may not apply to the community banks. Moreover, since the community banks in China started late, there is scarce personnel familiar with the financial system in community banks. Instead, many talents with strong marketing ability and sales experience tend to work for large or medium-sized joint-venture banks, which will bring more obstacles to the team construction of community banks and the subsequent operation and development.

4. Strategies and Suggestions for Sustainable Development of Community Banks in China

4.1 Construct a Comprehensive Supervision System

Since China has entered the era of the Internet and information technology, the related departments and institutions should effectively implement the supervisory responsibilities and benign supervisory competition. Firstly, on the basis of big data support, community banks need to make comprehensive use of electronic monitoring technology, and econometric models to supervise the community banks' asset and liability changes, capital clearing and efficiency, so as to prevent risks in advance and correct them in time. Secondly, it is necessary to clarify the responsibilities of financial supervisory departments. A strict internal control system, proper equity set-up, and corporate governance structure are the top priorities for opening supervision, clarifying the deposit insurance system, and risk disposal functions. Thirdly, standardize the information disclosure mechanism, ensure the accuracy, timeliness, and completeness of all information of community banks. Community banks should also set up a self-regulatory organization by making full use of social supervision tools such as accounting, credit rating, and asset evaluation to involve the public and shareholders in the supervision process.

4.2 Strengthen Technical and Talent Support

First, community banks must join the "Internet+" team and build mobile service workstations, intelligent terminals, and backstage operation centers to provide marketers and customers with intelligent, portable, safe, and compliant application platforms with good experiences. Through this workstation, community banks can cultivate more employees with "online" or "cloud" tools and carriers to expand service efficiency using Internet thinking. Second, in the era of information technology, talents are essential to community banks, and a great number of "Internet + Finance" composite talents are urgently needed. The new thinking of talent strategy is the key to the success of community banks in the new era. It is essential to develop a talent training program, cultivate talents through the "industry-university-research" model, and set up an effective incentive system. For example, through the bank's head office or headquarters, corporate with the professional schools and universities to build training classes. In order to meet the talent demand, intensive training is needed to reserve more high-end professional talents for the banks.

4.3 Accelerate the Development of Internet Finance and Credit Collection Services

Compared with large banks, the disadvantages of community banks are mainly reflected in their small scale and limited business scope. However, if community banks can innovate financial products, increase derivative businesses, and strengthen credit promotion to establish a healthy economic

ecology, they can reduce business risks while using more profitable financial tools to boost the regional economy. First of all, community banks should actively explore the Internet environment to create a complete and all-around business model for customers of SME. The detailed actions including accelerate the implementation of "cloud payment" cooperation, promote the type II accounts, cooperate with third-party companies, enhance the integration of online and offline development, and strengthen targeted products to create a unique Internet financial service model. Secondly, multi-channel synergy and overall service capability are the directions of efforts and key nodes for community banks. The formation of an integrated online and offline network helps to analyze customers' demands instantly and proactively market relevant products. Also, focus on the integration of commercial, public welfare, and service resources around the community to establish an integrated platform of "online sales (e-commerce) + offline services (community bank)." Thirdly, community banks need to focus on solving information asymmetry and pushing ahead with the implementation of a credit system to reduce credit risk. Under the government's leadership, community banks can rely on big data and cloud computing to build a network credit collection tool, improve the cloud-based credit collection system, and carve out a full spectrum of information. Finally, community banks should establish a sound information-sharing mechanism, which will support the social credit system and credit culture. Meanwhile, the government should make joint efforts by improving the relative laws and regulations to strengthen the disciplinary mechanism for breach of trust.

5. Conclusion

With the marketization of interest rates and advancement of Internet finance, China's urban commercial banks and rural medium-sized financial institutions are continually exploring the development model of community banks. Although compared with other banks, community banks in China are facing lots of challenges in business, regulation, human resources, and technology. They should also adopt measures based on local conditions. On the one hand, the community banks should continuously improve their core competitiveness based on community and provide personalized and diversified services to the market; On the other hand, they should actively cooperate with government departments and institutions, improve the regulatory mechanism and obtain support from various parties, so as to promote more community banks to gain a firm foothold in China and make more contributions to the regional economic development.

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