

CHINESE ECONOMIC AND FINANCIAL REFORMS:

Implications for Foreign Financial Institutions

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STATEMENT

This thesis contains no material that has been accepted at any other university for award of a degree, and to the best of my knowledge and belief the thesis contains no material previously published or written by another person, except when reference is made in the text of the thesis.

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Hong Jin Wang

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ABBREVIATIONS

AIA	American International Assurance Company
ANZ	Australia and New Zealand Banking Group Limited
ABC	The Agricultural Bank of China
BNP	Banque Nationle de Paris
BOC	Bank of China
BOCOM	Bank of Communications
CCP	The Chinese Communist Party
CIB	China Investment Bank
CITICIB	The China International Trust and Investment Corporation Industrial Bank
EFW	Employee Welfare Fund
GATT	The General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GM	General Manager
ICBC	The Industry and Commercial Bank of China
OUB	The Overseas Union Bank
NT \$	New Taiwan Dollar
PCBC	The People's Construction Bank of China
PBOC	The People's Bank of China
PRC	The People's Republic of China
SEZs	The Special Economic Zones

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ABSTRACT

Beginning in the late 1970s foreign banks were allowed to enter into China in line with the country's overall economic reform and opening up program.

Recently, many of the world's larger banks have entered the Chinese market and have settled into a strong presence in China, mainly through branches, operating subsidiaries and representative offices in coastal cities and Special Economic Zones. However, unlike other Australian industries which are strengthening their operations or cooperative undertaking in China, in respect of their number of operating institutions in the Chinese financial market Australian banks are behind many foreign banks such as those of the United States, Japan, Hong Kong, UK and France and so on.

There has been no systematic study of Australian banking industry entry into the Chinese market to date. This study attempts to identify the opportunities and challenges which foreign banks will face in the second stage of the Chinese economic and financial reforms. The study will also compare and evaluate the market strategies of French and Australian banks in China.

The survey focused on both Chinese and foreign banks in China. The findings indicated that the second stage of the Chinese economic and financial reforms should bring opportunities to foreign banks which should outweigh their challenges or difficulties. The study also indicated that Australian banks were in unfavourable position as compared with French Banks, and the business strategies of Australian banks are more conservative than those of the French banks.

1. INTRODUCTION

1.1 Background of Problem

Beginning in the late 1970s foreign banks were allowed to enter into China in line with the country's overall economic reform and opening up program.

In 1979, foreign banks were promised the right to establish representative offices. In the mid-1980s the establishment in Special Economic Zones of foreign branches, wholly foreign-owned banks, banking and finance company joint ventures followed.

As of the end May of 1995, 417 foreign bank representative offices from 33 countries and regions had been established (including banking offices, insurance offices and 2 security offices). They are distributed over Beijing, Shanghai, Guangzhou, Shenzhen, Dalian and so on, a total of 20 cities. About 123 foreign financial operational institutions from 14 countries had set up in 13 cities in China, 5 joint venture banks, 5 finance companies and 4 branches of foreign insurance companies (Mao Cao Jing, 1995).

As the statistical data of the People's Bank of China indicated, by the end of March 1995, the capitalisation of foreign banks amounted to US \$14 billion, deposits US \$2.53 billion, loans and investment amounted to US \$8.8 billion, among which 92% of total loans were within the boundaries of China (Mao Cao Jing, 1995).

More recently, many of the world's largest banks have entered the Chinese market, including banks from Japan, US, UK, France, Germany and Hong Kong. Yet by comparison with other industrialised nations, Australia appears to be lagging far behind these counterparts. As the People's Bank of China, Statistical Bulletin indicated, by the end of June 1993, Australia had one banking branch (ANZ) in China, compared with

Hong Kong 12, Japan 9, UK 8, France 6, US 5, Singapore 3; Australia had 4 representative offices in China, as compared to Japan 90, US 22, UK 20, Hong Kong 19, France 18, Italy 10, Germany 7 (the People's Bank of China, 1994). These figures show us that the Australian banks have not established a strong presence compared with other foreign banks.

In mid-November 1993, the Chinese Communist Party Central Committee endorsed a faster transition to a "socialist market economic system". The Chinese leadership announced a comprehensive package of the second stage of economic and financial reforms which if fully implemented, could ultimately make China an irreversibly free economy. The market economic system will attract more and more foreign financial organisations to share the fast-growing Chinese financial market activity in order to further expand their overseas operations.

In this study, although banks are the primary concern, other financial institutions which overlap with the normal activities of the banks are also considered. For instance, the insurance industry offers opportunities, to both banks and non-banks, and some limited attention is given to these emerging opportunities. However, to undertake a full-scale investigation of the insurance industry and its potential in China would be beyond the purposes of the present thesis.

The term 'foreign banks' means:

- the branches established in China by banks with head offices located in foreign countries, or in the Hong Kong and Macao regions, and which are registered in accordance with the laws of the People's Republic of China;
- banks with foreign capital, the head offices of which are located in China and are registered in accordance with the laws of the People's Republic of China (PRC).

1.2 Research Objectives

The purpose of this study is to:

- Identify the opportunities and challenges which the foreign banks will face in the second stage of the Chinese economic and financial reforms.
- Compare and evaluate the market strategies of French and Australian banks in China.

1.3 Significance of the Study

According to the People's Bank of China, many foreign bank branches have achieved a satisfactory performance since they were allowed to enter into the Chinese financial market. Yet unlike other Australian industries which are strengthening their operations or cooperative undertakings in China, in respect of their number of operating institutions in the Chinese financial market Australian banks seem to be behind other counterparts. In other words, one of the main competitive disadvantages of Australian banks seems that they have not been forming a truly comprehensive network in China. Therefore, one of the most important tasks is to understand the current financial policies, and political and economic environment in China if Australian banks want to share the fast growth of the Chinese financial market with local Chinese banks and other foreign bank branches. Also it is important to assess Australian banks' market strategies if they would like to catch up with other counterparts' position.

In this study, French banks will be chosen as a counterpart to compare their business strategies with those of Australian banks. This is because both France and Australia are middle power nations, and relatively have enough in common to make a comparison meaningful. Another important reason is: the international expansion of French banks has been fruitful since the 1860s, and their international expansion strategies seem to be successful enough to be usefully learned by Australian banks.

However, it is more difficult to make a comparison between Australia and other counterparts, such as Hong Kong, Japan, Britain and United States. The arguments for this choice are as follows:

Hong Kong is a part of China, it has long been China's primary trading partner since 1949. Its people of course have the business advantage of being from the same cultural background and having personal connections. On the other hand, most Hong Kong banks

are the sister banks or business partners of the Bank of China. During the period of isolation, they had played particular roles which cooperated with the Hong Kong Branch of the Bank of China, to assist China keeping in touch with western business practices.

Hong Kong also is playing an important role in China's economic reforms and opening up program. It is China's largest trading partner and is the leading investor in China, with total cumulative investment amounting to US \$ 10 billion at the end of 1992 (Genzberger & Hinkelman, 1994, pp 54-55). And so Hong Kong banks could be given more opportunities than those of other countries.

British banks predominated in the long prerevolutionary history of China. They provided short-term financing for the foreign trade of both foreign and Chinese merchants. They possessed an effective monopoly in international financing and constituted the foreign exchange market as well.

By 1952, almost all foreign banks had withdrawn from China, but the Hong Kong & Shanghai Banking Corporation and the Standard & Chartered Bank, two British banks, were allowed to remain in their limited capacity, the result of a deal between the United Kingdom and China whereby the Bank of China was permitted to maintain its London branch. These two British banks had spent over 30 years in hope and waiting to be permitted to expand their activities within China. Indeed, they were allowed to accept foreign deposits in the late 1980s. In a word, British banks possess a relatively privileged position in China and attribute this to the historical facts mentioned above.

The short history of US banking in prerevolutionary China largely involved short-term trade financing. US banks operated through branch or specialised banks as did British banks.

Although all US banks in postrevolutionary China were forced to leave after their property was expropriated or accounts were frozen, as a result of the Korean War, this

hostile relationship has improved since the early 1970s. The first US banks to develop correspondent relations¹ with the Bank of China were the Franco-American Banking Corporation of New York, in 1970, and Chase Manhattan of New York, in early 1973. At the end of 1978, following the establishment of full US - PRC diplomatic relations, several top US banks formally expanded to full correspondent relations. By March 1979 the list of US correspondent banks had expanded from just three (in 1975) to ten and has since grown dramatically (Reynolds, 1982, p81). Chase Manhattan Bank received permission for an office during the visit of its president, Willard C. Butcher, in late 1978. The Bank of America was given permission to open an office by Vice-Premier Li Xian Nian, during the visit of that Bank's president, A. W. Clausen, in 1979.

More recently, in spite of China and the United State having brittle relations over human rights issues, bilateral trading and cooperative projects are still increasing. The US is the second largest official investor in China, with approximately US \$ 8 billion by the end of 1992. It also is China's third largest trading partner (Genzberger & Hinkelman, 1994, pp.54-55). In February 1995, in Beijing, both the US and Chinese governments strongly criticised each other during the negotiation over intellectual property, but in the same week and at the same place, the US and Chinese Governments signed agreements about more than seven energy development projects in which official US bodies will invest, or will invest in cooperation with Chinese official bodies. Undoubtedly, US banks gain an advantage over Australian banks in entering the Chinese market due to both China and US having a significant common stake.

¹ A correspondent banking relationship exists when a bank uses the services of another bank with a separate corporate identity that is located in another city or country. Such a relationship is often reciprocal, ie., each bank renders services for the other. The services include forex transactions, originating and processing bills of exchange and other documents related to international trade, handling payments and collections, providing credit information about potential borrowers, and providing loans and services to clients (Mikdash, 1988: p 388).

As far as we know, Japanese businessmen do not win Chinese business persons' favour, because the Chinese nation has hardly forgotten about the suffering of the Sino-Japanese War. But Japan has gained greater benefits from various aspects such as direct trading investment, financial services and other economic cooperative projects since the economic reform and opening up program was enforced in China. For instance, Japan is China's second-largest trading partner, next to Hong Kong and followed by United States. In 1992, exports from China to Japan were 14% of the total, while imports from Japan to China were 17% of the total (Genzberger & Hinkelman, 1994, pp.54-55). A major reason for Japan's success in China is their superb business skill and market strategies. For example, the Japanese are not only good at dealing with the bureaucracy, government agencies and various business sectors to build up their personal connections, they are also good at seizing every opportunity to promote their products and increase their market share in China. Of course, the closer cultural background and geographical position also help Japan take advantage of the opening of the Chinese market. To sum up, whether in financial resources or business strategies, Australia appears to be inferior in a comparison with Japan.

This study intends to contribute to the Australian financial industry by encouraging it to establish or readjust market strategies in order to seize the opportunities and face the challenges which arise in the second stage of the Chinese economic and financial reforms.

1.4 Chapter Outline of Thesis

This thesis is organised into seven chapters. The first chapter deals with the background of the problem, the research objectives, the significance of the study, and the chapter outlines. The Second chapter provides an outline of the research methodology employed in this study, including the survey questionnaire, interviews with local Chinese financial institutions and foreign financial institutions which are located in China and Melbourne,

sources of secondary data and data analysis. The limitations of the research are also discussed in this chapter. The third chapter presents a literature review. The fourth chapter presents a review of the Chinese economic and financial reforms. Chapter five and six present the results of the survey and discuss the findings. The seventh chapter presents the conclusions arising from the research and puts forward a number of recommendations. Finally, five appendices follow the seventh chapter.

2. RESEARCH METHODOLOGY

Because of the lack of literature directly related to this research topic, this thesis take the form of an exploratory study. Interviews were conducted with the main focus being French, Australian, and other foreign financial institutions which are located in China and the local Chinese financial institutions(including the central bank - the People's Bank of China, commercial banks, and insurance companies).

This research was conducted in August - October 1995. Survey methods were: Face-to face interviews with the management and economists at local Chinese banks and foreign bank branches in two Chinese cities - Gaungzhou and Shenzhen; an interview with a Senior Manager at Colonial Mutual Life Assurance Society in Melbourne; the mailing of questionnaires to the local Chinese banks and foreign bank branches in the three major Chinese cities -- Beijing, Shanghai and Guangzhou.

2.1 Data Collection

Both primary data and secondary data was consulted for this study. The primary data came from responses to the questionnaires and interviews², while the secondary data was accepted from the sources listed below.

- Publications of business news.
- Chinese newspapers.
- Articles in journals and periodicals.
- Documents and articles from Chinese financial authorities and Chinese banks.
- Books.

² See App. C: List of the Chinese banks and foreign banks who were sent Questionnaires and interviewed.

2.1.1 Mail Questionnaires

Due to the exploratory nature of this research, qualitative data was required. Therefore, the questionnaires (Questionnaire1 & Questionnaire2³) comprise both open-ended and leading questions which aim to gather new information and data, to increase understanding of issues and specify new problems, rather than provide precise measurement or quantification. As is explained below (section 2.2) the responses to mailed questionnaires were limited. However, these response were useful in supplementing information obtained by interviews.

2.1.2 Interviews

In order to gain more detailed responses to the Questionnaires, face-to-face interviews were conducted at the local Chinese banks and foreign banks, at which the questionnaires (Questionnaire 1 and Questionnaire 2), which were designed to identify the opportunities and challenges for the Chinese banking system, and determine the type of strategies adopted by the Australian and French banks, were handed out. Interviews were conducted in August - October 1995. The interviewees ranged from top managers to middle level managers in the local Chinese banks' provincial branches and foreign bank branches in two cities in China. The time of interviews was from 40 minutes to 1.5 hours.

The reason why interviews were used was to explore, in greater depth, issues highlighted in the responses to Questionnaires, in order to assist in identifying the critical problems as well as in solving a number of related problems.

2.2 Selecting the Sample Population and Sample Size

Because of the focus on qualitative research, the number of financial institutions in my survey was not calculated using standard sample size formulas.

The elements in this purposive selection of financial institutions were:

- Solid representation of both Chinese financial institutions and foreign financial institutions.
- Chinese financial authority (the People's Bank of China) and the Chinese commercial banks.
- Banks and non-bank financial institutions (insurance companies).
- The business offices of foreign financial institutions (foreign bank branches) and the representative offices of foreign financial institutions.

The survey's main geographic focus is four selected major Chinese cities -- Beijing, Shanghai, Guangzhou and Shenzhen. Twenty randomly selected banks in the above mentioned areas(excluding Shenzhen) were sent questionnaire 1. Questionnaire 2 has been sent out to 11 banks (2 Chinese banks and 9 French & Australian financial institutions which are located in the three selected major cities -- Shanghai, Guangzhou and Shenzhen.

Interviews were conducted at 7 branches of local banks including the People's Insurance Company of China, Guangdong Branch) and 7 branches or representative offices of foreign banks in Guangzhou and Shenzhen (including one insurance company in Melbourne). Interviews provided the most useful information. Responses to mailed questionnaires, sent to financial institutions in all four cities, provided supplementary information.

Questionnaire 1 was sent to all four major Chinese state-owned commercial banks' Guangdong branches, while two Chinese financial institutions' headquarters and two regional branches of the People's Bank of China (see App. C,) were sent questionnaire 1. Questionnaire 1 was also sent to 7 foreign bank branches in Guangzhou, in addition to 3

³ See App. B.

foreign bank representative offices in Beijing and two foreign bank branches in Shanghai. Questionnaire 2 was sent to two regional branches of the People's Bank of China, while the only Australian bank's China branch - ANZ Shanghai Branch - and 66 % of all French banks' China branches(excluding the Sino- France joint venture financial institutions) were sent questionnaire 2. Moreover, 41.6% of foreign bank branches in Guangzhou and one Australian insurance company in Melbourne were interviewed. In addition two regional branches of the People's Bank of China, three branches of state-owned commercial banks, one regional commercial bank and one state-owned insurance company in Guangzhou and Shenzhen were also interviewed. In short, the responses provided a significant sample on which to estimate the current Chinese financial market environment parameters and trends, and to determine the business strategy parameters for the China branches of Australian and French banks. However, it would be unwise to claim that information gathered from four cities can adequately reflect the information in the whole of China.

2.3 Data Analysis

The data gathered from the method described generated a database for qualitative analysis, and cross tabulation was used to compare French and Australian banks' business strategies. The method of data analysis was mainly a qualitative one, with opportunity for only occasional percentage comparisons.

2.4 Limitations

Due to lack of time and money, questionnaires were unable to be mailed to all 130 foreign financial operational institutions in 14 Chinese cities. Also I was unable to send out questionnaires to all 426 representative offices in 20 Chinese cities. So the sample size of this study seems relatively small.

It was not possible to present the qualitative data collected from the open-end and leading questions in a comprehensive tabulated format.

Sixty five percent responses to mail questionnaires (The response rate of mail questionnaire 1 was 70%, the response rate of mail questionnaire 2 was 60%) is relatively sketchy, due to the respondents not providing detailed information or data.

Due to the confidential nature of the information, in responding to questionnaire 2, the respondents at French and Australian banks were reluctant to reveal information relating to the institutions' business strategies, particularly those which will be adopted to follow the current and future Chinese financial reforms.

3. REVIEW OF THE LITERATURE

The following literature review provides some information about the background to international expansion, benefits from international expansion, competitive advantages of foreign banks in developing and newly industrialised countries, and challenges facing foreign banks in developing countries and newly industrialised countries. Few studies directly related to the topic of this thesis, ie. foreign banks in China, have been conducted in the past. However, foreign banks entering the Chinese financial market place can expect to encounter experiences and problems similar to those encountered by foreign banks entering other developing and newly industrialised countries.

Ideally, a relevant literature survey would have included literature concerning foreign banks entering former socialist countries. However, literature search using CDROM resources available at Victoria University of Technology library did not yield any relevant material of this type. The countries for which there was literature available include a range of developing countries each of which would have its own particular circumstance, but at least an indication of common problems and experiences can be gathered from these sources.

3.1 The Background to International Expansion

Multinational banking was defined by Thorsten Döser(1990), as the operating of a bank in a number of different countries as opposed to doing business with those countries from home. Döser (1990) found that multinational banking has been primarily an American and European phenomenon. Following their empire-building the United Kingdom, France, Germany, Italy, the Netherlands and Belgium built up significant financial networks between 1880 and 1914.

Karl Erich Born (1983) also found that foreign branches, foreign subsidiary banks and direct investments in banks had been known since the 19th century, but their number was small until the 1950s.

Born(1983) found that from the 1950s, an increasing number of major industrial concerns, in order to gain a firm foothold in foreign markets, began to establish not only branches, but also subsidiaries in other countries which they provided with their own capital. This presented the banks with fresh tasks: as their major customers developed into 'multinationals', they were expected to satisfy the expanded transactional credit requirements of these large companies. Traditional methods, such as the use of an agency to represent interests abroad or a correspondent to deal with transactions, were no longer sufficient. In order to finance the multinationals, the banks were forced to follow their domestic customers and set up branches or obtain direct stakes in banks in those countries where the former had their subsidiaries. The multinationalisation of the banks followed upon the multinationalisation of industry.

The 1970s was a decade of tremendous growth for international banking. The emergence of consortia, foreign branch networks and subsidiaries overseas was reinforced by massive expansion of the Euro-currency market and the relative importance of the banks' overseas earnings (Skully, 1980). At the same time, advances in computer technology and telecommunications meant transactions could be made instantaneously between any of the main financial centres. Economies were becoming increasingly more interdependent and national financial regulations were more and more perceived as irrelevant to existing international business and constraining on expanding national concerns(Brown & Bell, 1989).

Studying international strategies of French banks, Métais (1990) reached a conclusion on international banking theory, stating that banks follow their domestic customers expanding abroad to finance their international trade flows, and their foreign investments, and to provide them with various financial services in their foreign host countries. Their

comparative advantage against foreign competitors in such activities is related to the ownership of some special intangible assets such as information about the true creditworthiness and specific needs of their customers.

3.2 Benefits from International Expansion

Brown and Bell (1989, pp 18-28) found that there was a limit to expansion within the domestic market and international banking provided the scope for both growth and high profitability. In 1979, the largest banks in US, for example, received approximately half of their earnings from overseas and even the major clearing banks in UK obtained about a third of their profits from international activities (Skully, 1980, p 98).

Kevin Davis (1985, p 26) in studying foreign banks' entry into Australia found that: "one of the contributors to growth of multinational banking has been the expansion of multinational business corporations. Not only will banks perceive benefits in their home market from providing worldwide service to these customers but they can be expected to offer some advantages over indigenous banks in servicing the needs of the multinationals in foreign markets".

Studying the international strategies of Japanese banks, Düser (1990) found that banks seeking emerging business opportunities overseas often did not have any direct link with Japanese companies moving abroad, but took up opportunities such as syndicated loans, Eurobonds, or the Californian retail market explosion, to establish a multinational presence. Japanese banks are the winners in international expansion, emerging as the biggest financial institutions of their kind in the world during the second half of the 1980s. Within a time-span of just 18 years they rose from representing none to representing eight of the world's ten biggest banks in 1988.

Investigating the performance of foreign banks in Australia, Anonymous (1993) found that the Overseas Union Bank (OUB) of Singapore was the first foreign bank to take

advantage of a year - old invitation to foreign banks to open branches in Australia. OUB has operated a merchant bank subsidiary in Sydney for the past 7 years, earning a modest profit of A\$ 209,000 in 1992 on assets of just A\$ 161 million. Established foreign banks in Australia, of which there are 18, may also follow OUB's lead and convert to branch status, rather than operating as a fully incorporated subsidiary under the new rules. For both old and new foreign banks, there is now sufficient incentive to do so, as Australia is at last a place for them to make money.

Tony Kaye (1995) also states that 1994 was a tremendous year in both Citibank's international and Australian business with a strong performance from its retail operations and products. It was expanding its branch network. The net profit of Citibank Australia in the year to December 1993 was \$ 104.5 million, an increase of 62 % over the previous year. Citibank's assets in Australia now totalled \$ 9 billion. This compares with \$ 8.79 billion in the preceding year. The group's capital adequacy ratio also was maintained at 13%, which is comfortably above the Reserve Bank of Australia's minimum 8 % ratio.

3.3 Competitive Advantages of Foreign Banks in Developing and Newly Industrialised Countries

Foreign banks operating in Korea have attained a much higher operating performance when compared with domestic financial institutions. These advantages generally have been achieved with the provision by these foreign banks of guaranteed profits by swap arrangements with Bank of Korea, a wider variety of financial services, strong funding power, and better financial management. The usual foreign bank operation results in losses during the first few years but a new bank operation in Korea has generally been profitable from the first year of operations. The Korean banking market has been quite attractive and this has been confirmed by the fact that some foreign bank branches have made annual net profits amounting to three to four times their total capital funds (Euh & Baker, 1990, p25).

Citibank is pursuing Asian entrepreneurs by the thousands. Citibank is redefining the region's notion of banking. Most important, it is pioneering the concept of consumer credit. Besides mortgages and automobile loans, Citibank offers 24- hour telephone banking and automated teller cards that can be used in Singapore as well as New York. As a result of Citibank's strategy, Citibank Asian accounts grew from 1 million in 1986 to an expected 5 million in 1992. In addition, annual profits rose accordingly, from \$28 million to a projected \$200 on revenues of \$1 billion. Citibank's growth in Asia is in stark contrast to the bank's poor performance in the US, where it continued to grapple with bad real estate loans. A major reason for Citibank's success in Asia is that most foreign banks still avoid developing countries, such as India, Indonesia, and Thailand. Their rationale is that these markets are too small and that consumers lack experience in handling personal debt (Engardio, 1992, p 66).

A study examined the importance of selected patronage factors used by Hong Kong commercial bank customers in choosing domestic banks versus foreign banks. Though Hong Kong bank customers use domestic banks more often, they perceive the usefulness of a select number of services in a similar manner for both domestic and foreign banks available in Hong Kong. The ranking of fast and efficient service and friendliness of personnel as patronage motives suggested that the banking industry needs to place emphasis on personnel training. The results indicated that foreign banks' success in Hong Kong was credited to a strategy of providing high - quality service to niche areas of the Hong Kong banking market. For example, Hong Kong Bank of Canada concentrates on trade finance in the corporate middle market (Kaynak & Kucukemiroglu, 1993, pp 139-157).

Jim Bodgemer (1994) found that foreign banks in Turkey have to work under many constraints. Their biggest problem was uncertainty. Many have moved into trade finance where they claim a competitive advantage. In 1993, Osmanli Bankasi fell in with a general trend among foreign banks away from branch status towards incorporation in

Turkey. The country's most recent foreign institution, Midland Bank, opened as a wholly incorporated concern because there were some tax advantages. Foreign banks were coming back into trade finance with a competitive advantage in sourcing foreign exchange.

3.4 Challenges for Foreign Banks in Developing and Newly Industrialised Countries

Euh & Baker, (1990) found that by the end of 1987, there were 32 foreign bank branches in Taiwan. All foreign bank operations were located in Taipei. These foreign bank branches had some limitations imposed on them by government regulations. Although they accepted NT\$ (New Taiwan Dollar) deposits which had maturities of up to 3 years, enabling them to expand their local currency loan operations, their total NT\$ deposits were limited to 12.5 times each bank's capital remittance from their home countries to Taiwan. Thus foreign bank branches in Taiwan had been able to provide only a little more than 5% of all loans made in the country.

Sender (1994) found that banks in Asia, be they local or branches of foreign banks, were too busy tending to the needs of Asian clients in both the public and private sectors. Executives in charge of Asia for many Japanese and American banks found that their head offices became more interested in their ambitious strategies to expand in the region. Korea banks, now well capitalised, became big investors in the paper issued by borrowers across the region, and the Taiwanese were trying to follow suit where politics was not a problem. Singapore's enviably well - capitalised banks were encouraged by the government to explore the challenging environment in China.

Studying the international market strategy of New York's Chase Manhattan Bank, Schwarz found that:

“Chase Manhattan plans to sell its consumer - banking unit in Indonesia and focus exclusively on serving corporate clients. This move is the most visible change in

approach by a foreign bank in Jakarta since Indonesia announced sweeping financial reforms in 1988. New banks and thousands of new branches sprung up in response to the reforms. The focus for most of them was on consumer-banking activities, leading to intense competition for deposits and clients. On January 24, 1992, Chase provisionally agreed to sell its retail - banking arm to Bank Universal, a privately owned local bank with a strong consumer-banking orientation. Chase executives insist that the US bank remains committed to doing business in Indonesia, but say it has been forced to focus its activities on more specific areas. Chase's move will be viewed with some trepidation by Bank Indonesia (the central bank), which does not want overseas banks and investors to conclude that Indonesia is hostile to foreign capital."

Anonymous (1993b) stated that:

"the problem with most Asia-Pacific financial markets is that they are insular. Multinationals are often hurt by restrictions on funding and lack of sophisticated financial systems as they try to build a presence in the region. Limits on offshore funding range from a near-total ban in South Korea to less-restricted attitudes elsewhere. Similarly, banking systems are either open or totally closed. In most cases, strictures on foreign banks abound, with limited foreign entry and ownership of local credit institutions. US money-center banks are pressuring Washington to lean on Asia-Pacific countries to open up their markets. Greater openness will also benefit multinationals, since restrictions hamper expansion plans. The following action points are recommended for multinationals in the region:

1. Seek new financing methods.
2. Carefully select investment projects.
3. Name a local partner.
4. Look for funding alternatives." (source: Crossborder Monitor)

Most foreign banks operating in South Korea were hit hard with lean times in the first half of 1994, recording a decline in their combined operating income for the second straight year. According to information from the Office of Bank Supervision, the combined operating income of 37 foreign banks (excluding 14 Japanese banks and one Indian bank) dropped a sharp 17% to 122.89 billion won in the first half of 1994 from 148.13 billion won in 1993. Only 10 banks posted net profit growth. These dismal results were primarily attributed to a large reduction in the demand for funds from large companies, which are major clients of the foreign banks. In addition, conglomerates are increasingly tapping the international capital markets, where the most competitive interest rates are available, to satisfy their large - scale funding needs (Anonymous, 1994 a).

Anonymous (1994b) found that foreign banks, facing ever-declining profits in Korea, have been shut out of the latest overhaul of Seoul's draconian foreign exchange laws, according to industry sources. The latest changes, which are due to become effective in June 1994 as part of the second step of gradual liberalisation of the foreign exchange laws, apply more to personal money management than corporate finance. South Korea's Ministry of Finance is viewed as being overprotective with regard to foreign exchange because of perceived violations by foreign banks in the past and abysmal performance of local banks in the international currency market.

Beside the above issues, most foreign banks have faced labour problems. In 1993, an arbitration panel appointed by the South Korean Labour Ministry was to settle the 2 - month long strike by union members at Citibank's Korean branch. In addition, the arbitration panel's decision could set the tone for other foreign banks which were likewise plagued by labour problems, as well as having broad implications for all unionised foreign companies doing business there. The crux of the Citibank dispute was the Union's demand that management create an Employee Welfare Fund (EWF), which would be funded from a certain percentage of a company's pretax earning and used for employee benefits such as low-interest loans for housing and educational expenses, in accordance with recommendations outlined by the Labour Ministry in 1992. Citibank

management argued that there was no need for the bank to establish an EWF, as the bank's own program offers greater benefits than those recommended by the ministry as well as the programs of other local banks (Anonymous, 1993 c).

Nick Bradbury (1994) found that changes were under way in banking markets around Asia that will lead to more services and more access to credit for medium-sized companies and entrepreneurs who previously had to make way for blue chip borrowers. Driving the changes are two factors: 1. The development of the region's capital markets, which will allow companies more choice in how they raise money, and 2. Increasing competition in the banking industry as more local banks and foreign banks are allowed at least partial access to markets. The pattern of change is not uniform throughout Asia. Where there is reform, the pace can vary tremendously. With capital markets opening up alternative money-raising avenues for top blue chips, Malaysia's banks have been forced to woo a different set of corporate borrowers. Now that paying attention to smaller customers has become necessary even for larger banks, improvements are being felt all around. The picture is similar in Indonesia and Thailand.

3.5 Summary of the Lessons Learned from the Literature Review

From the above, it can be seen that the foreign banks could encounter a lot of difficulties when the branches and sub-branches were established in their host countries, particularly in developing and newly industrialised countries. Restrictions on business activities seem to be the biggest barrier for foreign banks entering these countries. Generally, foreign bank branches have had some limitations imposed on them by the host countries' government regulations, and are also often hurt by lack of sophisticated financial systems, changing policies and so on. However, under such tough circumstance, most foreign banks have achieved satisfactory performance with their sophisticated business skills and

aggressive marketing. In other words, aggressive marketing has been employed by foreign financial institutions to make profits in their host countries. The above experiences of foreign banks operating in developing and newly industrialised countries could be regarded as the valuable lessons that are significant for my study of the situation facing foreign banks and financial institutions entering the China market.

4. REVIEW OF THE CHINESE ECONOMIC AND FINANCIAL REFORMS

4.1 The Background of The Chinese Economic Reforms

In 1978, after Deng Xiaoping went back into office, China made a bold commitment to rush into the four modernisations (science & technology, agriculture, industry and national defence). Economic modernisation began to take priority over everything else. That December, the party Central Committee declared its top priority: to close the large - scale nationwide mass movement and to shift the emphasis of our party's work and attention of the whole people of our country to socialist modernisation. After that a set of economic reform and opening up policies such as decentralising, quasi - market reform, encouraging the establishment of private enterprises, price reforms, financial system reforms and opening up to the outside world, have been practised and have had marked success.

4.2 Review of the Chinese Financial System Reforms From 1979 to the Early 1990s

From 1979 to the early 1990s, China had moved from a monobanking system to a financial system that is typical of that in an industrialised country. Considering the political, economic, and social environment that prevailed prior to 1979, China's achievements in reforming the financial system are quite commendable. The essential achievements of reforms will be reviewed in the following part.

4.2.1 The Dismantling of the Monobanking system and Proliferation of New Domestic Financial Institutions

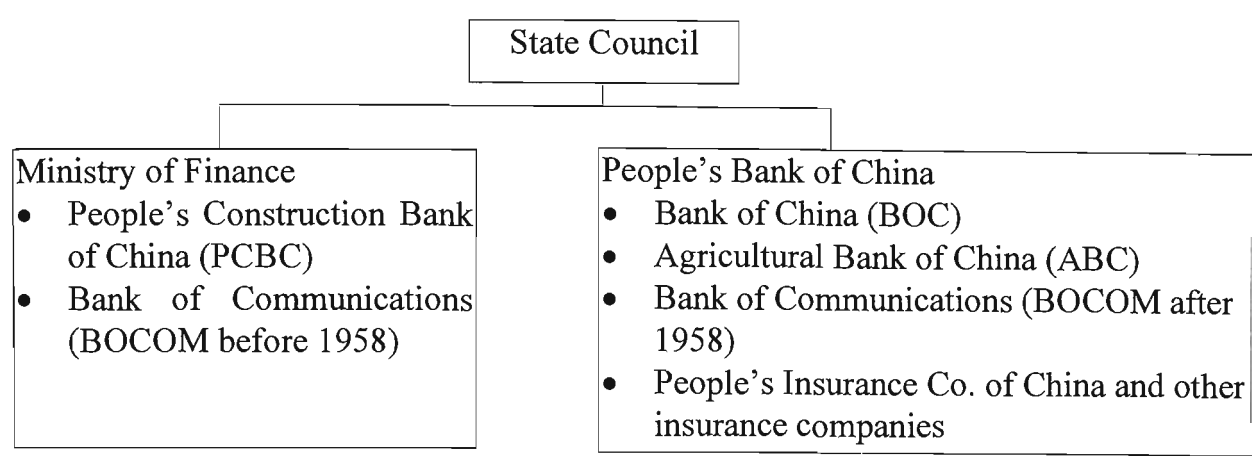
On October 1, 1949, the People's Republic of China was established, and the money supply, price levels and inflation were of serious concern. The People's Government realised that only by stabilising and developing the economy can the Chinese Communist Party consolidate its power.

The People's Bank of China (PBOC) which had been founded on December 2, 1948, through an amalgamation of three Chinese banks (North China Bank, Beihai Bank, and Northwestern Peasant's Bank), played a key role in the unification of the economy's financial and economic affairs after 1949 and until 1984. Under this unitary and highly centralised banking system, PBOC functioned as both China's central bank and its main commercial banking system. The head office, branches, sub - branches, and associated agencies handled activities relating to the issuance of currency, deposits, loans, settlements and remittances.⁴

PBOC also incorporated the operations of other banks until 1979. For this reason, the Chinese banking system was called a monobanking system up to 1979. Figure 5.1 illustrates the monobanking system and its relationship with the Ministry of Finance which had administrative control over other financial institutions.

⁴ During the Cultural Revolution (July 1969), the head office of PBOC was incorporated with the Ministry of Finance. The branches and sub-branches were operated by the rules set by the various provinces, municipalities, and autonomous regions. On January 1, 1978, by State Council resolution (" Several Decisions on Consolidating and Strengthening Banking Work," November, 1977), PBOC functioned independently of the Ministry of Finance. By the end of 1978, PBOC had regained its branches and sub-branches and continued normal operations (Chen and Zhao, 1990: 28-29).

Figure 4.1, the Monobanking System and the Ministry of Finance



Source: The People's Bank of China, 1994, "the Financial System Reform," China Financial Outlook, p32.

Under the unified credit plan, the above monobanking system was simply a distributor of funds according to plan and watchdog supervising the spending of those funds. This traditional planned financial system and hierarchical command structure enabled China to function in the modern world. Under the Chinese financial system reform program of 1978, the monobanking system was dismantled and the reform also created the climate for the establishment or reestablishment of specialised banks designed to serve specific sectors, again partially as arms of state policy and partially as profit-making enterprises. The establishment of the specialised banks broke up the excessively centralised and unified financial system and greatly enhanced the business activity and the motive force of the development of China's financial industry (Zhu, 1994). Besides the establishment of specialised banks, a number of non-banking financial institutions, quasi-official and regional banking or non-banking financial institutions had sprung up in the period of the 1980s. Some private financial institutions have appeared in the Special Economic Zones. Wholly foreign-owned and joint venture banks and non-banking financial institutions have been again allowed to operate in China since late 1979.

4.2.2 Strengthening the Functions of the Central Bank

During 1948 to the 1980s, within the context of a planned economy, the People's Bank of China(PBOC)'s role in financial policy matters was severely limited due to the Chinese government's control of fiscal appropriation. In other words, the PBOC functioned as the rubber-stamp organisation charged with doling out the funds allocated to enterprises by the State Planning Commission. With the purpose of making the PBOC the central bank in the real sense and implementing the financial system reform program, during the 1980s , China's State Council allowed the PBOC greater autonomy to actually manage the financial system. The PBOC has gradually cast off retail banking activities to transform itself into a real central bank, with the establishment of the Chinese state-owned specialised banks. The PBOC has strengthened its central banking functions and played a crucial role in the transformation of China's banking system into a market-driven sector since the mid-1980s(PBOC, 1994).

4.2.3 Creation of the Chinese Financial Market

The earliest activity in the securities markets in China can be identified as far back as 1914, when the Shanghai government enacted legislation to permit the trading of securities in Shanghai. China's first securities exchange was established in Shanghai to trade in treasury bonds. Later, exchanges were set up in other cities. After 1949, all securities were abolished, exchanges were closed, and bureaucratic capital was confiscated. Securities trading in China came to a halt until the 1980s, when, as a result of the open door policy and its associated economic reforms, securities trading resumed in several cities in China. By 1988, China had experimented with securities in the primary and secondary markets(Jin, 1990). The period 1990-1991 witnessed continuing reforms and consolidation of the securities markets. Both Shanghai and Shenzhen Securities Exchange were opened at the end of 1990 and in early 1991(Fan, 1995).

The interbank and foreign exchange markets are two powerful institutions involved in the mobilisation of funds in the Chinese financial system. Interbank business became popular in the mid-1980s and was intended to promote the horizontal circulation of funds across banks, industrial sectors, and regions in the country. In 1986, the interbank business was encouraged by the State Economic Structure Reform Committee and PBOC.

Over the 1949-1979 period, foreign exchange control took a back seat in China's national economy while the nation was closed to the outside world. Yet with the open door policy and the resulting economic reforms, starting in 1979, China paid increasing attention to its capacity to generate and retain foreign exchange (PBOC, 1994).

4.2.4 Allowing the Entry of Foreign Financial Institutions

Beginning in 1979, China started to implement its economic reform and opening up program, and it was necessary to introduce some degree of competition. The entry of foreign banks into China puts some competitive pressure on the domestic banking industry. Moreover, the admission of the foreign banks was for the purpose of attracting foreign capital to finance China's economic development, as well as to introduce banking know-how to upgrade its financial system.

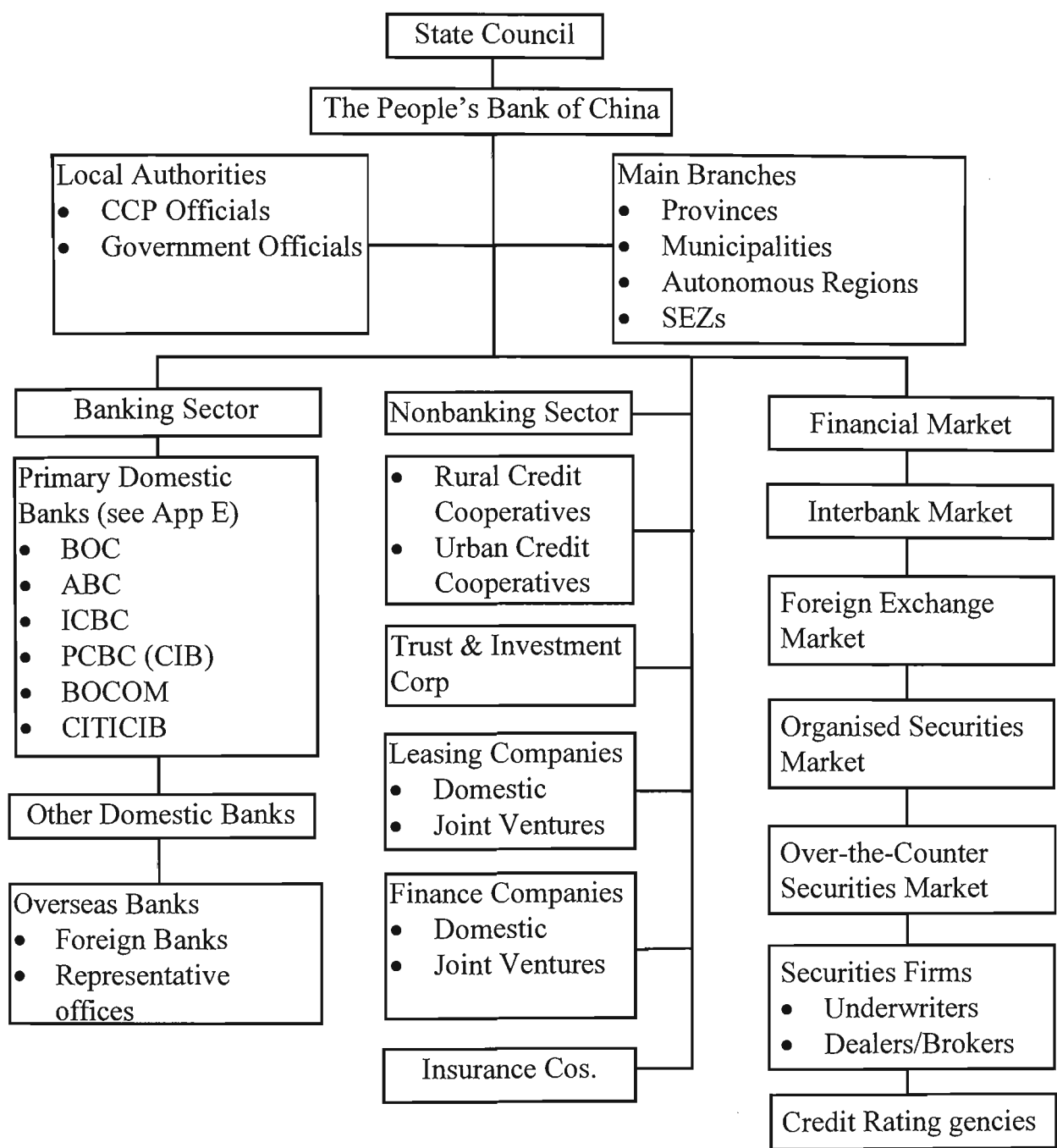
In December 1979, the State Council permitted foreign banks to establish representative offices in Beijing, and the Export-Import Bank of Japan was first to do so. In 1982, the Nan Yang Commercial Bank of Hong Kong and Natong Bank from Macao were allowed to open a branch in both Shenzhen and Zhuhai Special Economic Zones. In 1980, China Oriental Leasing Co. was established as the first joint venture leasing company in China involving foreign banks and Chinese financial institutions. This set a pattern for similar financial institutions and for joint venture finance companies in the mid-1980s. By 1985, there were approximately 32 joint venture leasing companies and 3 joint venture finance companies operating in China. By the end of 1990, there were an estimated 209

representative offices in 14 coastal cities. By the end of 1991, there were 32 foreign bank branches and 5 non-banking enterprises in China(Zhu, 1994).

To sum up, the Chinese financial system reforms undertaken since 1979 are quite numerous. During the previous 16 years, China was changing from a ledger-transaction to a cash society, and monetary control was needed. Credit management was becoming important and interest rates had to play a greater role in the allocation of funds. The State was resorting to the domestic and foreign debt market so the management of government debt and associated market operations had to be given greater attention. Foreign exchange management became important, considering the expanded relationships with the international community. The entire financial system had to be supervised and controlled for orderly reform and further development (Dipchand, Zhang & Ma, 1994).

After the reform era, the financial system is reflected in Figure 4.2 on the next page.

Figure 4.2, the Chinese Financial System as It Had Evolved by 1990



Source: the People's Bank of China, 1994, "the Financial System Reform," China Financial Outlook, p82.

4.3 The Second Stage of Chinese Economic and Financial Reforms

4.3.1 The Background of the Second Stage of Economic Reforms

Although China's economic reforms have had marked successes since 1978, and its economy became the fastest growing in the world in the 1990s, it was widely accepted that the piecemeal reforms adopted over the previous decade had not resulted in a free market (for land, labour, capital and management) with prices determined by market forces. So against a background of rising inflation, inadequate infrastructure, agricultural bottlenecks, losses occurred in over 40% of state-owned enterprises (50% in some regions and sectors), industrial output continued to decline in state-owned enterprises and private enterprises grew fast. (Gordon, 1994).

Under the circumstances, Deng Xiaoping was extremely worried that the existing results of reforms would be destroyed in a moment. He once again surfaced to preach the gospel of economic reforms, because he recognised the need to embark once again on the road of reform. In early 1992, Deng made his now famous inspection trip to Guangdong and the Special Economic Zones in order to impel the current Chinese leadership to increase the pace of reforms and to establish a socialist market economic system as soon as possible. During his trip, Deng made reference to the “capital measures” that were needed to move China forward, and he criticised Jiang Ze Min, the party General Secretary & President, and Li Peng, the Prime Minister for their attitudes to reform without mincing words. Deng also pointed out “ anyone must be removed from office if they do not practise reforms!”

4.3.2 The second Stage of Chinese Economic and Financial Reforms

In 1993, the National People's Congress officially approved Deng's free market policies, and declared that a "socialist market economy" will replace central planning. In mid-1993, the Chinese Communist Party's Central Committee endorsed a fast transition to a "socialist market economic system." The Chinese leadership announced a comprehensive package of economic and financial reforms which, if fully implemented, could ultimately make China an irreversibly free economy. The package included taxation reforms, state-owned enterprise reforms and a shift to joint stock corporations, labour market reforms, social security system reforms, and intensification of the financial system reforms, etc (State Council Office for Economic Systems Reform, 1994).

4.3.2.1 The Second Stage of Chinese Financial Reform

Although the Chinese financial reforms undertaken since 1979 are quite a success, and the old management operating system has been fully replaced by new systems which fit the "socialist market economic" system, there are some problems in macro control and in administering the financial industry. In the 1990s, there has been a rapid increase of the ratio of market to non-market operations in the Chinese economy and a drastic clash between the financial system and the economy's performance. The challenge caused by this clash keeps pushing the financial system reform onto a higher level.

In November 1993, the Chinese State Council announced a rather sketchy blueprint for financial reform. The second stage of financial reform was presented in the following aspects: (Sources: the People's Bank of China, the People's Construction Bank of China, and the Investment Bank of China):

◆ Promoting the Macroeconomic Regulation System of the Central Bank

The People's Bank of China is to be transformed into a genuine central bank which will control and supervise China's financial system. To make the People's Bank of China the central bank in a real sense it must establish an effective macroeconomic regulation

system. The State Council clarified the major function of the PBOC, which is to formulate and implement monetary policy and to keep the currency stable, to conduct strict supervision on financial institutions, and to keep the Chinese financial system operating in a safe and effective way. There is a different focus in functions between the head office and branches of the PBOC. The head office controls the issuance of currency, basic currency management, interest rate adjustment and regulation of the total amount of credit. The PBOC at and below provincial level branches focuses on financial supervision and control, inter-bank position adjustment, research and statistical analysis, management of state treasury, cash transfer, foreign exchange control and inter-bank clearance. In other words, the PBOC head office will solely be responsible for the formulation and implementation of monetary policy and the formulation of financial regulations, while its branches at and below provincial level will be responsible for financial supervision and provide all kinds of service to the government and financial institutions (the People's Bank of China, 1994).

◆ **The Separate Establishment of Policy Financial Institutions**

Three new government policy banks (China Export-Import Bank, the State Development Bank, and the Agricultural Development Bank) were established to take responsibility for state-directed loans and in turn free the existing 4 large state-owned specialised banks -- the Bank of China, Industry & Commercial Bank of China, the People's Construction Bank of China, and Agricultural Bank of China.

The main function of the State Development Bank is to fund capital investment in the key sectors such as energy and transportation and other key infrastructure. It also undertakes the medium-term or long-term development projects of the state.

The functions of the China Export-Import Bank are: to follow the state's export -import policy; to provide medium or long-term low rate loans to Chinese international trading enterprises; and to promote exports. Its operations include import credit (buyers' credit & suppliers' credit such as arranging credits for the purchase of Chinese capital equipment,

materials), overseas investment and providing guarantees against credit and political risk and so on. The Agricultural policy-oriented bank is to fund agricultural development projects and make subsidised loans to poor farmers in remote and depressed areas of the country.

◆Transition from the State-owned Specialised Bank to the Commercial Banks

The aim of this reform is to transform the existing state-owned specialised banks into state-owned commercial banks which assume sole responsibility for their profits or losses. The general provisions of the Commercial Banking Law of the PRC are presented in Appendix D of this thesis.

These banks will compete with each other for banking business across the board instead of servicing policy goals in specific areas. They will be relieved of the responsibility of extending special policy loans on the orders of the State Council. This will allow the existing financial entities to concentrate on market competition without having to divert resources for policy considerations. The People's Bank of China is improving its system of control and adjustment for state-owned banks. It also plans to actively search for appropriate measures for asset-liability proportion management and asset risk management under the credit ceiling, so as to raise the capital usage rate and to set up a loans control mechanism. These state-owned banks are searching for methods of managing state-owned assets. They are also trying to establish a supervising committee to monitor and supervise management principles, to check the value of the state-owned capital, and to supervise, evaluate and keep track of the operational performance of the bank executives so as to forward suggestions on appointment or removal, rewards or punishments. (The People's Bank of China, 1994).

◆Developing the Money Market and Invigorating Financing

The money market is an important place for the central bank to carry out its macroeconomic regulation. The main problem in the money market in China is the lack of an explicit definition of participants and regulations, which results in mixing up the inter-bank position in the market with the inter-financing market. Another problem is the lack of sufficient qualified bills as the means to increase and decrease the monetary base in the money market. The third problem is the direct flow of funds from the money market to the capital market without investment control at present, contributing to investment expansion and a craze for real estate and stocks. In 1994, the People's Bank of

China planned to regulate the operation of the money market. They formulated three restrictions on the behaviour of the money market.

The first one is that all financial institutions, including the branches and prefectures of specialised banks are only allowed to borrow cash position within 7 days, while the borrowing of cash position beyond 7 days can only be conducted among legal entities. Because of the gigantic systems of specialised banks, and the inconvenience of fund management, specialised banks can grant authorisation to some of their branches to conduct lending activities across systems. The second one is as the banks have superfluous funds after they borrow money from the People's Bank of China, they should first repay the loans to the central bank and are not allowed to extend loans with maturity of 7 days lending across systems. The last one is, to prevent the funds flowing from the money market into the capital market, banks and urban credit cooperatives are not allowed to lend money to trust and investment companies and securities companies. The inter-financing of funds beyond these three restrictions should be invigorated to its maximum, using bills as much as possible.

◆ Construction of Financial Legislation

In order to fit the rapid development of the Chinese financial industry and guarantee the smooth reform of the Chinese financial system, in the late 1980s the Standing Committee of the National People's Congress incorporated a set of financial laws into the five year legislation plan. This financial legislation plan was included to establish the Act of the People's Bank of China, the Banking Act the People's Republic of China, Bills of Exchange Law, and Insurance Law, etc. The drafting of the above four financial laws was started in the early 1990s and completed in 1993. Their draft texts were submitted to the State Council for examination and approval in 1993 to 1994.

In March 1995, the Act of People's Bank of China was approved by the National People's Congress and enforced from that time. The Act of the People's Bank of China as a central bank act would govern the activities of the People's Bank of China specifying

its status, functions, power and obligations in the socialist market economy, ensuring its relative independence and authority in formulating and implement currency policies, strengthening supervision and control over the financial industry, and guaranteeing the stability of the Chinese legal tender and financial order as a whole (Mu, 1995).

The Commercial Banking Law of the People's Republic of China (Adopted at the 13th Session of the Standing Committee of the Eighth National People's Congress on May 10, 1995) is an act to regulate the activities of commercial banks in China (See Appendix D below). The law has for the first time specified legal requirements in detail in regard to the establishment, alteration and termination of commercial banks and their business operations. The other functions of this act are that supervision and control over banks can be based on it, and it will protect the legitimate rights and interests of banks. In a word, the act will provide more decision-making power to the commercial banks so that they can operate independently, and take up responsibility for their profits and losses, develop business and bear risks themselves.

The Bill of Exchange Law will ensure normal use and circulation of all valuable papers and protect the legitimate rights and interests of their holders and others involved.

The Insurance Law (Adopted at the 14th Session of the Standing Committee of the Eighth National People's Congress in 1995) which was to operate from October 1, 1995 will strengthen control over the insurance industry and standardise insurance activity, in order to protect the interests of insurers and insured and guide insurance onto a healthy path of development. Except for the Act of the People's Bank of China, the three other laws were expected to be approved by the Standing Committee of the National People's Congress and to be enforced in 1995.

Besides the above four laws, a number of financial administrative regulations have been submitted to the State Council for study including: Regulations of the State Development Bank, Regulations of the China Import-Export Bank, Foreign Exchange Regulations of

the People's Republic of China (revised), Gold and Silver Control Regulations of the People's Republic of China (revised) and so on. A few financial regulations are being drawn up or will be drawn up including: Trust Administration Regulations of the PRC, Administration and Approval of Financial Institutions, etc (the People's Bank of China, 1994).

For the purpose of expanding international economic and financial co - operation so as to be conducive to the introduction of foreign capital and technology to promote the growth of China's economy, the Regulations Governing Foreign Banks and Joint Chinese - Foreign Banks in Special Economic Zones of the PRC were formulated in April 2, 1985. A summary of these regulations is presented in Appendix D of this thesis. These regulations are the most important guiding principles for foreign banks entering China's banking industry and operating their business activities in China. Only by knowing and deeply understanding these regulations can a foreign bank design and set correct business strategies to expand its business scope.

In a few words, the Act of the People's Bank of China and the Commercial Banking Law of the People's Republic of China, as the legal base and core for China's financial legal system, can play a vital role in ensuring smooth implementation of the Chinese financial reforms. The other laws and regulations can play a supporting role in the financial reforms. Although whether these laws and regulations could be enforced effectively and efficiently is still a question mark, nevertheless it is obvious that the Chinese Government's decentralised control over the financial sector will soon be formalised in these financial laws, and the financial legislation will establish the socialist market economy in a real sense.

◆ Other Financial Reform Measures

- A national interbank clearing system was established in order to improve banking efficiency. The project is being funded in part by the World Bank.

- Exchange rate reform was carried out in 1994. This reform plan consists of 2 stages. The official exchange rate for the renminbi (China's currency) was abolished and the currency system was unified as the first step in the program for eventual decontrol, a step which was implemented on January 1, 1994. Free convertibility of the renminbi is the second step of the program which will be implemented by the year 2000.
- Irregular capital-raising were prohibited. The leverage of interest rate flexibility began to be used by the banking system.
- A national securities exchange system was established in order to develop the long-term capital markets.
- The Urban Cooperatives Bank was established, an offshoot of the Urban Credit Cooperatives.
- China's first private commercial bank, Minsheng Bank, was allowed to be established in 1995. The main function of Minsheng Bank is to guide and help the entry of private enterprise into international markets.
- Restrictions on foreign bank business were relaxed in relation to scope, operation and location. Foreign banks will be permitted to engage in domestic banking business such as renminbi business and so on after completion of the domestic commercial banking reforms and when the renminbi becomes more convertible (Yang, 1994). This will be a very important change when it occurs as is evident from the responses of interviewees (See chapter 5).
- The Chinese financial market was further opened to the outside world. The Chinese insurance market was opened to foreign insurance companies step by step in a planned way, in order to introduce more foreign capital to support Chinese economic

reconstruction and to prepare for entry into the General Agreement on Tariffs and Trade (under whose rules China should not have barriers to entry in the domestic banking industry).

So far, the second round of economic and financial reforms in China remains on track because the 1.2 billion Chinese share one goal, they want to get rich and have a stable society. The Chinese leadership must go along with this goal, and the reform will therefore be continued in the post-Deng era. There remain many problems and challenges which foreign banks are already facing, and will continue to face in their operations in the China market. These problems and challenges are the subject of the following chapter.

5. OPPORTUNITIES AND CHALLENGES FOR FOREIGN (AUSTRALIAN/FRENCH) BANKS IN CHINA

5.1 Introduction

In Chinese history foreign banks have been, for a long time, associated with the word “foreign imperialism”. Chinese literature frequently presented foreign banks’ role as exploiting the country and natives. Without doubt great attention has been given to foreign banks as these entities together occupied a dominant position in the Chinese local economy prior to the Chinese Communist Party taking over the country.

The negative feeling towards the foreign banks finally took a drastic turn after 1949, when most foreign banks were expelled from the country’s banking system with the Chinese government taking control of foreign exchange and foreign trade. Though the revised regime, along with a new set of regulations, was for the purpose of protecting the ‘lawful right and benefits’ (in the eyes of the proletariat) within the Chinese banking system, this severely limited the scope of operation for those foreign banks which were left behind. By 1952, many foreign banks voluntarily closed down their operations and left China in the face of low earning opportunities. The final phase of exodus had left behind four foreign banks⁵ operating in Shanghai, plus the Overseas Chinese Bank in Xiamen.

As mentioned earlier, foreign banks were allowed to enter into China’s banking industry in the late 1970s due to the country’s overall economic reform and opening up policy. The admission of the foreign banks was for the purpose of attracting foreign capital to finance China’s economic development, as well as to introduce banking know-how to upgrade China’s financial system. The authorities believed that the entry of foreign banks into China would introduce competition pressure into the local banking industry

and they hoped that local banks would be forced to take action to improve their operational skills and services.

As mentioned in Chapter 3, China's regulatory framework for foreign banks is restrictive and wide-ranging. Despite the restrictive regulatory structure, I believe that it is possible for foreign banks to thrive in China's banking industry with proper strategies and sound operational policies. In order to establish adequate strategies and policies, it is important to understand the government's regulations, and the political and economic environment of the country.

With the second stage of the Chinese economic and financial reforms implemented in 1993, it is expected that remarkable results will be achieved by the economy. Under these reforms there will be changes in the Chinese financial market, and it is important that foreign banks adjust their strategies accordingly, so as to take advantage of opportunities or overcome any challenges.

In order to identify the opportunities and challenges which the foreign banks will face in the second stage of the Chinese economic and financial reforms, this part of the thesis includes a survey of both the Chinese and foreign financial institutions located in the four selected major cities-- Beijing, Shanghai, Guangzhou and Shenzhen. Twenty questionnaires have been sent out to 20 randomly selected banks in the above mentioned areas (excluding Shenzhen). (Questionnaires are shown below in Appendix B. A respondent is asked to answer 'Questionnaire 1'. In brief, 'Questionnaire 1' tracks the banks' perceptions about opportunities and challenges for the banking system.). The response rate of mail questionnaires was 70%.

⁵ The HongKong & Shanghai Bank, Standard & Chartered Bank, East Asia Bank and Chiyu Bank.

Face-to-face interviews were conducted at 7 branches of local banks and 7 branches of foreign banks in Guangzhou and Shenzhen. The interviewees were senior managers in both domestic banks and foreign bank branches.

The survey results were satisfactory and especially the interviews resulted in quite a lot of relevant findings. The results and findings will be discussed in the following part of this chapter.

5.2 The Second Stage of Chinese Economic & Financial Reforms and New Business Opportunities.

As mentioned in Chapter 4, in late 1993, China announced a reform program to restructure banks and financial markets to fit the needs of an economy that increasingly resembles the capitalist model. The implementation of the second stage of the Chinese financial system reform program has been the focus of world attention. It also is a popular topic for foreign businesspeople and bankers. If banking and financial reform is successful, China's prospects for continued advances will receive a critical boost. Otherwise, the country will fall into a situation where chronic inflation and widespread unemployment will lead to general economic and social chaos (Genzberger and Hinkelman, 1994). In other words, the current and future Chinese financial market environment is a key factor for the performance and development of foreign banks or joint ventures.

According to Chinese economic and financial journal articles from the Peoples' Bank of China, the Chinese authorities and economists considered that the current and future financial market would provide more opportunities for foreign business in China.⁶ Most foreign financial institutions are expecting that the current reforms could bring high

⁶ Reference to a series of reports "Review of the Chinese Financial Market opening" (the Survey Team of the PBOC, 1995).

earning opportunities to their business activities, and the reforms will create a smooth business environment for financial institutions.

According to the survey (see App. B, Questionnaire 1: Q3 to Q11), most senior managers from the People’s Bank of China and other local Chinese commercial banks believe that the second stage of Chinese financial reforms increased opportunities for foreign financial institutions to expand their business activities in China. However, 80% of interviewees and respondents from the branches of foreign banks considered that the current reforms do not provide more opportunities for their business activities at the present stage, and that the difficulties and limitations on the scope of their business are no different from those which existed before 1993. But almost 90% of interviewees believed that the current reforms would create a smooth market situation and potential business opportunities for foreign financial institutions in future years.

5.2.1 Implications of the Policy of Further Opening the Financial Market

Responses to issues related to the current Chinese economic and financial reforms, and the increased opportunities for foreign banks (see App. B, Questionnaire 1: Q3) raised in this survey are detailed here.

At interviews with people at the foreign financial institutions in Guangzhou the interviewees, including all respondents from foreign banks, stated that by comparing the Regulations Governing Foreign Banks and Financial Institutions in People’s Republic of China (which came into operation on first of April, 1994) and the Regulations Governing Foreign Banks and Sino-Foreign Equity Joint Venture Banks in Special Economic Zones of the People’s Republic of China (promulgated by the State Council on April 2, 1985), the controls on operations of foreign financial institutions are still strict, and the scope of their business activities is limited.

Ronald Jim, Deputy General Manager of Guangzhou Branch, Banque Nationale de Paris, considered that although the reform of the Chinese banking system has entered an unprecedented stage of development since 1994, and a new set of financial laws and regulations has come into force, they still encounter difficulties in expanding their business. In other words, the second stage of reform has not fully opened up the Chinese financial market to foreigners. This is because foreign financial institutions can only engage in foreign currency operations, and the opening of renminbi business to foreign banks still has a long way to go. It is very clear that only when foreign financial institutions can enjoy the same national treatment as the local Chinese financial institutions in the country, only then they can gain satisfactory results from business expansion.

In this survey, many interviewees from foreign financial institutions mentioned the issue of “national treatment”; namely, they wish that foreign banks would be allowed to engage in local banking (renminbi) business as soon as possible. Most senior managers from Guangzhou branches of foreign banks agreed with the opinion of the deputy GM of BNP. However, Luo Zhong, Senior Officer of the Guangzhou branch of the Bank of East Asia, had a different perception of opening the renminbi business to foreign banks. He stated, that: “We hope that the renminbi business will be opened to foreign banks soon, but this operation must have as an essential prerequisite the establishment of a standard renminbi inter-bank market and a clearing centre for bills of exchange”. According to the current financial reform program which was announced by the State Council in November 1993, a pilot scheme for a national inter-bank clearing system is being implemented. If the second stage of financial reforms is fully implemented, foreign banks will be allowed to engage in domestic banking business and they may find it easier to repatriate profits.

When responding to the above question, the senior management and economists of Chinese local banks gave contrary views and comments.

At the interview, a manager from a division of the People's Bank of China, Guangdong Branch, believed that the current Chinese financial reform is increasing business opportunities for the foreign banks. She used two sets of data to support her argument. The first set is from the statistics of the People's Bank of China. It shows that: by the end of 1994, the accumulation of loans made by the foreign banks amounted to US \$ 8.8 billion, among which 92% of total loans were within the boundaries of China. Another set of data is the proportion of foreign currency loans between foreign banks and Chinese local banks in Shenzhen, Guangzhou, Shanghai and Xiamen. The details are as follows: in Shenzhen, the outstanding balance of foreign currency loans of foreign bank amounted to US \$ 2.4 billion by the end of 1994, which amounted to 50% of the total foreign currency loans in Shenzhen; in Guangzhou, the outstanding balance of foreign currency loans of foreign banks was US \$ 0.73 billion by the end of May 1995 which made up one-fourth of total foreign currency loans in that city; by the end of 1994, the outstanding foreign currency loans of foreign banks was US \$ 3.16 billion in Shanghai, which accounted for one-third of foreign currency loans for the whole of Shanghai; the outstanding foreign currency loans for Xiamen's foreign banks reached US \$ 0.36 billion by the end of 1994 which amounted to one-third of the total foreign currency loans of that city.

Several managers from the Chinese commercial banks stated that although foreign banks cannot engage in the renminbi business at the moment, they can enjoy some forms of preferential treatment. For instance, the foreign banks which set up in the Special Economic Zones and the coastal cities can enjoy a favourable tax rate of 15-30% on income tax, whereas the local Chinese commercial banks must follow the official tax rate of 55% when paying their income tax. Thus, the above respondents and interviewees complained that the foreign banks could enjoy "better than national treatment" on taxation.

At my interview with the Deputy President of Guangdong Branch of People's Construction Bank he noted that the Chinese banking industry must fully open to the

outside world (and actually, the Chinese financial market has opened a big gate to the foreign financial institutions since 1994), as this is an unavoidable trend, since China is preparing to enter into the General Agreement on Tariffs and Trade (GATT). According to market criteria and the rule of national treatment of GATT, a member of GATT must open its banking industry and financial market, allowing foreign financial institutions freely to engage in the domestic banking business and financial services. The set of financial reforms, especially the second round of financial reforms, mostly were designed to fit the need to open up the Chinese financial market. The implementation of reform programs such as exchange rate reform and the establishment of a set of new banking laws are providing a healthy financial environment for opening up the market. The entry of foreign banks has put pressure on the international financial operations of the Guangdong Branch of the People's Construction Bank. It pushed the bank to accept the idea of competition and to work hard to perfect its service functions, improving its means of service and raising its level of service with an unprecedented sense of urgency.

A Senior Economist from the China Investment Bank stated that the operations of foreign banks have developed rapidly since 1994, and most foreign financial institutions rely on their competitive advantages (such as capital, high quality service, people of talent and sophisticated banking technology and so on) to expand their market share. For example, in Dalian which is a huge industrial city that also boasts the second largest harbour in China after Shanghai, the local Chinese banks started to engage in international operations and foreign currency deposits in 1988. Up till the present moment, the outstanding balance of foreign currency deposits of four Chinese local commercial banks - the Industrial & Commercial Bank of China, the Bank of China, the People's Construction Bank of China and the Communications Bank of China - only amounted to US \$ 0.4 billion, while the outstanding balance of foreign currency deposits of six branches of foreign banks which have been established less than two years have amounted to US \$ 0.3 billion. The experts of the Dalian banking industry are surprised by a big increase in the operational development of foreign banks. The business

successes of foreign banks are challenging the international operations of the local Chinese commercial banks.

At the interviews, many senior managers from Chinese commercial banks stated that although most foreign banks are always complaining that the scope allowed them is too limited and too difficult to develop , nevertheless the numbers of foreign financial institutions are on the rise, especially the numbers of operational institutions which have doubled and redoubled since late 1993. A Manager of the People's Bank of China provided the following data to prove the above point. As of the end of June 1993, foreign banks had 56 operational institutions and 260 representative offices in China. However, by the end of July 1995, foreign banks had 130 operational institutions in 14 cities and 426 representative offices in 20 cities in China. The rate of increase could be illustrated by this example: at the end of 1994, there was only one Canadian operational institution - the Shanghai Branch of the Royal Bank, but at present (Dec. 1995), there are over six Canadian operating institutions (the branches of banks) in China. Among these are three branches which have been set up (branches of the Royal Bank of Canada, the Bank of Nova Scotia and the Bank of Montreal) in the city of Guangzhou.

Besides increasing the numbers of their operating institutions, many foreign banks are seeking every possible way to expand their operating networks. For example, by the end of June, 1994, the Bank of Tokyo had set up three branches in China, at Shanghai, Shenzhen and Dalian. On July 18 of 1995 the Beijing branch was established. By the end of 1994, Banque Nationale de Paris had two branches in China(branches at Shenzhen and Tianjin). In early 1995, the Guangzhou Branch started to operate and the Bank also was seeking opportunities to enter the inland Chinese cities (such as Wuhan, Chongqing and Shenyang and so on) which will be allowed to have foreign banks.

This Manager further noted that despite many foreign bank branches complaining their business activities in the Chinese market are restricted within narrow limits⁷ and the operational costs are relatively high, most foreign banks are still profitable, many branches have been making profit from the second year of operations, some branches even have been profitable from the first year of operations. According to China Daily (Xin Hua News Agency, 1996), in 1995, all 11 foreign bank branches in Tianjin were profitable with the total profits amounting to US \$ 800 million.

From the above, we can see that, although most foreign banks complained that it is too difficult to do business in China, based on the statistics of the People's Bank of China in 1993, the numbers of foreign financial institutions have increased rapidly. Most of the measures in the second stage of Chinese financial reform were designed to promote the opening up of the Chinese financial market.

5.2.2 Would Financial Legislation Create a Conducive Financial Market Environment ?

The respondents and interviewees from both the Local Chinese Banks⁸ and the branches of foreign banks⁹ did not believe that the financial legislation is favourable for fair competition between foreign and local financial institutions(see App. B, Questionnaire 1: Q4 and Q5). The majority of the interviewees pointed out that the People's Bank of China Act and the Commercial Banking Law of the People's Republic of China do not contain any articles mentioning the issue of a fair competition between foreign banks and local Chinese banks. In China, it is very difficult to have fair competition unless there is clear legal provision for it.

⁷ See App.D: the regulations for foreign banks in China.

⁸ People's Bank of China, the People's Construction Bank of China, and China Investment Bank.

⁹ The Bank of Nova Scotia Guangzhou Branch, the Bank of Montreal Guangzhou Branch, Banque Nationale de Paris Guangzhou Branch, Banque Indosuez Guangzhou Branch, the Beijing Representative Office of ANZ and so on: see App. C.

Sophie, a Project Finance Manager at the Guangzhou branch of Banque Indosuez, stated that fair competition would be impossible even if there were clear legal provision to cover it. This is because most financial laws are too brief, and sometimes in a concrete case the relevant clause to solve the problem cannot be found. According to the usual practice of the Chinese Government, the People's Bank of China is responsible for the interpretation of regulations and for guiding the enforcement of the financial laws. In addition, the branches of the People's Bank of China exercise routine regulation and supervision of the foreign financial institutions in their jurisdiction. Generally, there are several interpretations of one article due to the level of understanding of the people in charge of this job. Therefore, there are quite a few unwritten provisions besides the existing written ones.

According to the interviewees, most of the Chinese financial institutions were avoiding control during 1992 to 1994, and their capital finance and credit were in short supply. In 1994, the operational revenue of most Chinese commercial banks decreased, and profits dropped to the lowest level in this decade. A comparison made between the local banks and foreign banks shows that the competitive advantages of the foreign banks in international financial operations are greater than those of most Chinese commercial banks (except Bank of China and some regional banks). For example, foreign banks have advantages in technology, information networks, quality of services and human resources, etc. For this reason, the interests of domestic Chinese commercial banks must be protected by both the existing written and unwritten provisions. In other words, although the People's Bank of China has relaxed the regulations on scope of business and location, the business activities of foreign financial operational institutions are still limited by many unwritten provisions.

In short, fair competition between the local Chinese commercial banks and foreign banks still has a long way to go. The Manager of Trade Finance at the Bank of Nova Scotia had the same opinion. He stated that the Chinese authorities do not allow foreign banks to

operate in the main parts of the Chinese financial market, and they consider that foreign business should serve as a secondary supporting pillar in the development of the Chinese economy. As a result, the interests of Chinese commercial banks were placed ahead of everything else when the Chinese legislative body established the relevant banking acts or financial laws.

Several senior managers or senior economists from the People's Construction Bank and China Investment Bank also agreed that fair competition is impossible before the establishment of a perfect Chinese banking system and a financial market environment, because the competitive advantages are different between foreign banks and Chinese commercial banks. Foreign banks possess advantages in many aspects, for example, sufficient capital, variety of banking products, qualified accountants, economists, and technicians, computerisation and so on. The local Chinese commercial banks would lose a number of customers and a part of the market if they were not protected by both the existing written and unwritten provisions. Without this protection, the foreign banks would regain the dominant position in the Chinese financial market as was the case before the Communist Party took over in China. In other words, in the case of developing and newly industrialised countries, and even in the case of most developed countries, no one could fully open their financial market to foreigners and completely release the regulations and limitations on the business activities of foreign banks. Undoubtedly, it is not possible to fully open up the Chinese banking industry to foreigners, as well as necessary to have reasonable limits on the business activities of foreign banks.

An Assistant Representative at the Swiss Bank Guangzhou representative office stated that the Chinese government adopts regulations to limit foreign banks' business activities in some aspects in order to ensure the smooth development of Chinese commercial banks. These protective measures are necessary to increase the pace of development and improvement of the Chinese banking system. Yet, this protective period for state-owned commercial banks must be ended as soon as possible, he said.

At an interview, Ronald Jim, Deputy General manager of Guangzhou Branch of Banque Nationale de Paris had a similar point of view to that of other foreign banks interviewees. He noted that no articles of fair competition between local Chinese banks and foreign banks have appeared in banking laws or regulations, and the scope for business operations of foreign banks is still very limited. Thus the foreign banking operational institutions are currently only allowed to engage in foreign currency deposits; loans; discounting of foreign currency bills; foreign currency guarantees; exchange in foreign currencies; settlement of import transactions and consulting services, etc. The service targets are rather limited; generally, the customers must be foreign enterprises, Chinese-foreign joint ventures and Chinese-foreign cooperative enterprises. Of course, every foreign financial operational institution wishes that the above business scope could be expanded to include domestic business as early as possible. The objective of the foreign banks investing in China is not just profits from the foreign currency business in China. The real purpose for foreign banks coming to China is to share the Chinese financial market with the Chinese commercial banks. Although foreign banks cannot operate in the local currency business area, Mr Jim believed that the banking laws which were promulgated and enforced in recent times may urge the Chinese special banks to complete their transformation soon. The financial legislation would gradually improve the Chinese banking system and financial environment and especially would promote the implementation of the measures in the second stage of financial reforms. A healthy financial market environment will be created if the second stage reforms program can be fully implemented.

From the above discussion it can be seen that the 'Law of the People's Republic of China on the People's Bank of China', 'Commercial Banking Law of the People's Republic of China', and other financial laws which were adopted in 1995, did not mention fair competition between foreign banks and domestic banks. It is believed that the competition cannot be fair if there are no relative legal provisions. However, the enforcement of these financial laws and provisions would impel local commercial banks

to reform their management systems. It also would create an orderly financial market environment. Once financial control has been relaxed, foreign financial institutions will be able to do business easily.

5.2.3 Building Up the Institutions' Reputation and Customer Connections

As mentioned in chapter 3, the Chinese State Council and the People's Bank of China are preparing to partly open renminbi operations to foreign banks in the coming five years. Ninety percent of respondents answering the questions (see App. B, Questionnaire 1, Q7, Q8 and Q9) stated that a sophisticated banking system, sufficient capital in foreign currency and efficient service systems are the main competitive advantages of foreign banks in their business activities in China over those of the Chinese commercial banks. However, on the aspects of service network and renminbi capital, foreign banks found it difficult to equal the Chinese commercial banks. The respondents all agreed that the business activities of foreign banks would not improve greatly if they could not engage in the renminbi business, even though the foreign banks have the advantage over the local Chinese commercial banks in both hardware (such as capital, banking facilities and computerisation etc) and software (such as qualified personnel, quality of services, variety of services and efficiency etc). Further, several interviewees believed that the renminbi business is the key to operating in the Chinese capital market for both local commercial and foreign banks, though there are some different views and comments on the above questions which are shown below.

Local Views

At the interviews, several senior managers of the Bank of China and the People's Construction Bank of China complained that the development of the business activities of foreign banks has been swift and sudden. Foreign financial institutions rely on their capital, management skills and flexible business operation techniques to develop their

business. The expansion of the business operations of foreign banks is challenging the operations of the Chinese state-owned commercial banks, and many Chinese banks have lost international settlement and other foreign currency business to foreign competitors.

President of the Shenzhen Branch of the People's Construction Bank of China pointed out that the foreign banks have three main advantages:

First, foreign currency strength: the shortage of capital is a long-standing problem in the Chinese monetary market, and foreign currency is especially tight. On the other hand, the lending business of Chinese commercial banks is limited by the credit ceiling or other factors. Thus, the foreign banks could supply sufficient capital in order to satisfy the needs of customers.

Second, talented people: taking people as the foundation is an important principle in operating a business. A business will flourish when it has talented people. Competition is, in the final analysis, the competition for talented people. The foreign banks possess various qualified economists and accountants. The skills of the staff of foreign banks are higher than those of the local Chinese commercial banks' staff. In fact, foreign banks have not introduced many qualified and skilful staff from their home countries; a large number of key staff came from the local Chinese commercial banks. Generally, the foreign financial institutions offer excellent pay and conditions to attract the qualified staff of local Chinese commercial banks to transfer to their companies. As a result, many qualified and skilful staff leave their institutions one after another. In some local banks, all the key staff of their international division has gone to the foreign banks within a short period of time. The Chinese commercial banks have suffered heavy losses. This is because the loss of a qualified person not only means the irrevocably lost of training input, it also means the customers of this bank would be lost, and the foreign bank would take over this person's customer network easily.

Third, Sophisticated Means of Settlement: undoubtedly, in the aspect of international settlement, foreign banks provide very efficient and effective services to their customers. For instance, on the same sum of foreign currency from Tokyo to Guangzhou, the service of foreign banks is several times or even over ten times faster than local banks' service. Thus, the foreign banks are of course chosen by the international trading companies to deal with their large amount of foreign currency business.

To sum up, foreign banks are relying on the above advantages to scramble for international financial business in competition with the Chinese commercial banks. The rapid development of the business activities of foreign banks puts pressure on Chinese commercial banks and makes most domestic bankers feel puzzled and threatened. Of course, the impact of the entry of foreign financial operational institutions is just at the initial stage, as there are regulations restricting the business activities of foreign banks so as to protect the interests of the Chinese commercial banks. For example, foreign banks cannot engage in renminbi operations and the number of operational networks is strictly limited.

However, the Chinese State Council has been determined to speed up the pace of financial reform and further open the Chinese financial market to foreign financial institutions, even though local banks are not commercial banks in the real sense of the term at the moment. Most Chinese bankers who were interviewed believed that the Chinese commercial banks will enter the international financial arena, and foreign financial institutions will widely and deeply participate in financial market competition in the country.

Most Chinese commercial banks currently suffered from problems such as bad debt and a nominal credit ceiling which was topped by the actual credit ceiling. These problems rose from the government policies and the existing banking system, which are discussed elsewhere in this thesis.

According to the estimates of a Director at the Investment Research Institute of the People's Construction Bank of China, Guangdong Branch, whom I interviewed, large numbers of state-owned enterprises are in the red in recent years, and the number of money-losing enterprises and the sum of the loss will increase continuously. As a result of the above issues, the capital of banks is declining seriously because these state-owned enterprises (borrowers) failed to repay the principal and interest on their loans. The ratio of bad and doubtful accounts to the outstanding balance of loans is over twenty percent, more than 320 billion renminbi, including principal and interest which borrowers have to repay to all Chinese commercial banks. According to unofficial estimate, "perhaps 20% of Chinese banks' assets are in bad debts," he said. This disastrous consequence caused the economic returns of several major local banks to decline. For instance, the profits from the Guangdong Branches of several Chinese commercial banks (except the Bank of China, Guangdong Development Bank, the Merchandise Banks, and other provincial banks) were only book surpluses while the actual economic results were losses in 1994. As everybody knows, fixed asset investment rapidly expanded from the early 1980s to 1993 which led to credit inflation. In other words, for all Chinese commercial banks, the nominal credit ceiling was topped by the actual credit ceiling.

The above mentioned problems brought about serious consequences for Chinese commercial banks, such as decreasing economic returns, decreasing asset liquidity, an unreasonable credit structure and so on. This increased the risk of financial failure.

Only when the transformation program is completed and Chinese banks are transformed from special banks into profit-oriented commercial banks with full functions and flexible management system, will these risky factors be eliminated.

In compliance with the requirements of the State Council and the People's Bank of China, domestic banks have taken various measure since 1994 to accelerate the transformation of their management systems. They are paying attention to effectively

adjusting their credit structure, strictly controlling and reducing their credit size, improving the banks' liability structure and reinforcing their financial strength.

Clearly, local banks are experiencing an adjustment period. The reduction of credit size causes the banks to be unable to supply adequate money to fit the needs of their customers. For the local banks, business activities would be influenced by the above mentioned factors, and of course, their customer networks also would be damaged. For the foreign banks, it is a good opportunity to build up connections with domestic clients (such as state-owned enterprises or enterprises in other ownership) in order to be prepared for the opening up of renminbi operations. My informant from the People's Construction bank believed that most of foreign bankers will jump at the chance.

A Deputy General Manager from the Credit Department of the China Investment Bank stated that the foreign financial institutions regard high quality service and beneficial results as the life of their institutions. This point is reflected in strict management systems and close attention to market competition. In order to pursue maximum profit, foreign banks often carry out new varieties of operations, and control and manage their loans effectively. Every foreign bank has rigorous regulations to control its loan business. For instance, in some foreign banks a loan would be considered as overdue bad debt if payment has been defaulted for more than three months. There is a rule in their credit management system that the ratio of overdue accounts to the total amount of loans should not exceed 1 %.

Although the Chinese commercial banks also devoted much attention to improving the quality of service with beneficial results, they still have a long way to go to catch up with the foreign banks. Most local banks are short of specific and powerful means of operation, and in particular they lack powerful risk management systems to manage credit risk and risk exposure, which can be regarded as a key factor causing inefficient economic performance in the Chinese banking industry. For instance, while the foreign

banks keep the ratio of bad and doubtful accounts under the level of 1 %, local banks still try hard to keep this ratio under the level of 18 % or even higher.

It is observed that the local banks are not comparable to the foreign banks in their management systems. Under these circumstances, the operation of Chinese commercial banks would be affected greatly if renminbi operations were open to the foreign banks. Therefore, many Chinese financial experts and bankers appeal for the People's Bank of China to slow down the pace of opening the Chinese financial market to foreign financial institutions, especially for the renminbi business.

A General Manager of the International Division of the People's Construction Bank of China, Guangdong Branch, said that although the competition between domestic banks and foreign banks is in favour of the former, this affects the Chinese banks very differently. For example, in the early days of the foreign banks' entry into the city of Xiamen, one of the most attractive cities, the domestic banks' foreign currency business shrank for a short while, and the foreign banks' international settlement operations rose from the 20 % of the whole city's operational capacity to about 50 % of the total international settlement activities of the city. However, the present competition between the domestic banks and foreign banks has been in a relatively steady condition in several cities such as Shanghai, Shenzhen, Guangzhou and Xiamen. The market share of the foreign banks' international settlement operations is back to the normal level which is about 20 % in the above cities.

It must be recognised that the competition between the domestic banks and foreign banks will be sharper and sharper as the financial market further opens up. It is believed that the Chinese banks' foreign currency and international banking business will be greatly influenced after the foreign banks engage in renminbi operations.

Of course, many Chinese bankers wish that the period of financial market protection could be extended so that the domestic banks would have enough time to reform and

improve their management systems. Yet the opening of the financial market and in particular opening the renminbi business to foreigners is seen to be a general trend of the times. This is because China is preparing to resume its position in the GATT, and its domestic financial business has to be fully or partially open to foreigners once China become a member of the GATT. Most Chinese bankers believed that the opening of the Chinese financial market to foreigners will push Chinese banks to upgrade their operational systems and business skills. According to these senior managers, the foreign banks' engagement in the renminbi business will be crucial. Thus the period of transition of the Chinese specialised state-owned banks to commercial banks can be considered as an opportunity for the foreign banks. The foreign banks should take advantage of this period to prepare to enter into the renminbi market.

Foreign Bankers' Views

Further interviews were conducted with four senior managers of the Bank of Nova Scotia (Canada), the Banque Indosuez (France), the Banque Nationale de Paris (France), and the Nan Yang Commercial Bank (Hong Kong). These interviewees have similar points of view to those of the above local interviewees on the advantages of the foreign financial institutions.

In an interview with Jack Xie, Manager of Trade Finance at the Guangzhou Branch of the Bank of Nova Scotia, Mr Xie stated that the competitive disadvantages of foreign banks are in the following areas:

- A limited number of branches and operating subsidiaries

For the purpose of protecting the interests of the Chinese banks, the People's Bank of China promulgated a set of regulations to restrict the foreign banks' business scope, location, number of branches and offices and so on. According to the regulations of the People's Bank of China, the business activities of foreign banks are restricted to the areas where there is a high concentration of wholly foreign-owned and Sino-foreign joint-

venture investment activity, with a network confined to a small number of branches and operating offices. Obviously, the limitation on the number of branches and operating offices led to the fact that the presence of foreign bank branches could not be as strong as that of their Chinese counterparts.

- A limited business scope

As mentioned earlier, the foreign branches are only allowed to deal with the foreign currency business, and most of their customers are foreign enterprises. The ability to offer renminbi- denominated deposits and loans has been promised but has yet to materialise, although many foreign banks indirectly handle such business by steering clients to domestic bank offices for such loans. Of course, it is impossible for the foreign banks to play a major role in the Chinese financial market; they are only allowed to play a supporting role in the Chinese local economy. But the business activities of foreign banks cannot be expanded, and also they cannot make high profits, if they are not allowed to deal in local currency.

- Business culture

Chinese people possess many characteristics that are difficult for Westerners to understand. Their world view has been shaped by very different experiences and cultural traditions. For instance, personal connections are the key element in doing business in China. An organisation's or a person's relationship with the individual and the respect accorded him is probably the key to business success in China. Chinese banks understand this Chinese traditional business culture, that every organisation has to build up a very strong relationship with the authorities, government agents, customers and so on. Foreigners generally found it very hard to grasp the moral values and traditional concepts that shape the Chinese mentality. In other words, the foreign banks as newcomers in the Chinese financial market found that they cannot cultivate close personal ties with Chinese business associates as well as the Chinese banks, although most foreign bankers already know that they must attach importance to cultivating these relationships.

Mr Xie considered that such disadvantages are barriers that hinder the development of foreign banks in China. Most foreign bank branches have tried in every possible way to increase their business activities, although many difficulties were faced by them in terms of the permitted scope of their business. For example, for the purpose of increasing operational activities and building up service networks with domestic clients, the branch of the Bank of Nova Scotia has extended three months short-term foreign currency loans to some profit-making state-owned enterprises. State-owned enterprises are still playing major roles in China's economy, although more than one-third of China's state-owned enterprises are losing money. In the loans business, a large proportion of loans continue to be earmarked for state-owned enterprises which soak up most available credit.

The reason for a foreign bank branch to enter China is not only to provide banking services to clients who came from its home country. One of the most important reasons is to expand the business into the large Chinese market. Clearly, foreign bank branches must pay attention to doing business with the state-owned enterprises in order to achieve their purpose of business development. Building up connections with state-owned enterprises is not only a business strategy for the expansion of the bank, it may also be considered the first stage of involvement in renminbi business operations.

Sophie, Manager of Project Financing, Guangzhou Branch of Banque Indosuez, stated that the branches of foreign banks have honoured their good reputation with their high quality and efficient operation in China's financial market.

Many foreign bank branches have participated in key Chinese construction projects. For instance, the Banque Indosuez's China branches successfully raised medium and long-term foreign exchange funds from France, Italy, Belgium, United Kingdom and Holland by means of government loans and syndicated loans. The proceeds of such loans are used to support domestic key projects and the construction of infrastructure.

In theory, foreign bank branches are not allowed to engage in renminbi operations, but in reality, many branches have been dealing in operations relevant to the renminbi business. For example, in Guangzhou, foreign bank branches were permitted to open renminbi current accounts, so that they can use renminbi to purchase foreign currency from foreign enterprises, Sino-foreign joint-venture enterprises and Sino-foreign corporate enterprises, and then sell this foreign currency to the People's Bank of China in order to gain renminbi. Although foreign banks could not gain a great deal of profit from this area of operations, it would help them to reinforce their confidence while waiting to fully engage in the domestic business.

Mr Vincent, Manager of Operations and Administration, Guangzhou Branch of Hong Kong Nan Yang Commercial Bank, said that the foreign bank branches should not just wait for the Chinese government to open the renminbi business to them. Foreign banks on the one hand should help local banks to improve their management systems and upgrade their service skills. On the other hand, they should be very keen on introducing new varieties of banking operations. In other words, they should try to create business opportunities on their own initiative. For example, the Shenzhen Branch of Nan Yang Commercial Bank has introduced many sophisticated financial products, services and methods from Hong Kong and other countries to Shenzhen Economic Special Zone since 1982. This Branch also introduced one of the new banking products, namely "Mortgage" to Shenzhen. "Mortgage" was an unfamiliar term for the Chinese and most local banks had never provided real estate loans. Currently, this operation is being popularised by local banks and Nan Yang Bank has gained a strong footholds in the Chinese market. Mr Vincent further stated that the branches of Nan Yang Commercial Bank should be fully prepared to do renminbi business in order to gain an advantage over other foreign counterparts after the People's Bank of China opens up the renminbi operation to foreigners.

Bernard Bareges, General Manager of the Guangzhou Branch, Banque Nationale de Paris, had similar views to those of the above interviewees. However, he added that they

wish their branch could do renminbi business as soon as possible, but the establishment of a national interbank clearing system is an essential prerequisite for opening up renminbi operations. This project needs the joint efforts of both the foreign banks and local banks if it is to be achieved. In fact, if this project is implemented smoothly, it is believed that it will be very helpful for their entry into renminbi operations after the People's Bank of China opens up domestic banking business to foreigners.

The above results indicated that the foreign bank branches have built up very good reputations in the Chinese market due to their competitive advantages such as foreign currency strength, providing high quality and efficient services, the sophisticated means of operation and so on. Those good reputations will assist foreign banks to build up connections with domestic clients, and to be prepared for the opening up of renminbi operations.

5.2.4 Expanding Service and Clientele Networks in Order to Increase Market Share

From Sub-section 5.2.3 we learned that one of the key disadvantages of a foreign bank in China is the limitation of their business scope. Some foreign banks complained that their network of services and clientele are quite narrow due to the fact that they are not allowed to deal with domestic banking operations. However, many foreign bank branches have become conscious that the expansion of service and client networks is one of the important business strategies to develop their business and enhance their presence in China. Currently, most of the foreign bank branches not only provide services to foreign enterprises or Sino-foreign joint venture enterprises but also provide high quality and efficient foreign currency services to some local clients. Yet according to the survey as discussed in Sub-section 5.2.3, many foreign bank branches have devoted most of their attention to developing business relationships with the Chinese state-owned enterprises.

Undoubtedly, the Chinese state-owned sector still dominates the Chinese economy, although many state-owned enterprises are in trouble at the moment. However, the dominant position of the state-owned sector has been challenged by other-ownership enterprises such as private enterprises, wholly foreign-owned enterprises or Sino-foreign joint venture enterprises since the late 1980s. For example, in the early 1980s state-owned enterprises accounted for 80% of China's industrial output. By 1992 the figure had fallen to 55% and was declining fast. Moreover, as at 1991 total output of state industries grew only 8 percent while that of private enterprises grew by 24 %. The size and the number of enterprises has grown rapidly since 1990. According to official statistics, in 1992 there were nearly 140,000 private enterprises operating in China. Presently, in the economically well developed regions such as the Pearl River Delta, the Southern Fujian Delta and Shandong Peninsula, non-state-owned enterprises are playing dominant roles in the light industrial sector(Chen, 1995).

Clearly, with rapid development, the private sector has become an important sector in the economy's construction and development, and therefore it has attracted more and more attention. It seems to offer a new opportunity for both Chinese banks and foreign banks (especially for foreign banks) to expand their network of services and clientele.

With the purpose of exploring both Chinese and foreign bankers' attitudes towards the new business opportunity, I had discussions with several senior managers in the branches of the foreign banks and two senior managers and a senior economist of the Chinese banks. However, I did not gain satisfactory statements from the foreign bankers. They have not paid much attention to developing business relationships with private enterprises although they recognised that private enterprises are becoming more and more important in the Chinese market.

On the other hand, Mr Lu and Mr Zhou, Senior Economist of the Business Development Department, Guangdong Branch of the People's Construction Bank of China, and of the

Industrial and Commercial Bank of China, stated in my interviews with them that on the first of July 1995 when “Commercial Banking Law of the People’s Republic of China” came into effect officially, the largest four specialised banks, namely, the Industrial and Commercial Bank of China, the Agricultural Bank of China, the People’s Construction Bank of China and the Bank of China, were enabled to transform into State-owned Commercial Banks. The behaviour of these commercial banks, who are now profit-oriented and focused on making loans to the private sector, will attract a lot of attention in the next few years.

Mr Lu said that in the past, making loans to private enterprises was prohibited for the specialised banks. Even now, private enterprises are still not officially recognised as bankable entities, and some state-owned banks have been restricted literally from providing loans to these entities in the private sector. According to the nature of the Chinese commercial banks, a commercial bank operates independently and takes responsibility for all risks it may encounter, bears its own profits and losses, and exercises self-regulation in line with the management principles of economic efficiency, safety and liquidity. In other words, maximum profit and economic efficiency have become priorities among other goals. As a result, providing loans to the private sector without breaching the “Commercial Banking Law” is seen as possible. Yet the lendable funds within the state-owned banks are tight and the majority of their clientele are still state-owned and collective enterprises. The traditional concept of service and clientele networks will not change rapidly to meet the demands of the private sector.

As mentioned above, the private sector has become an important part of China’s economic construction and development. According to several financial experts, most private enterprise owners are well educated and have strategic vision. They also have relatively abundant funds, high levels of technology and complex industrial structures, stable business channels and therefore competitiveness in the market place. Some big private enterprises have even established Sino-foreign joint ventures which are comparable with some of the state run ones. According to unofficial estimates of one

Chinese financial expert, there are hundreds of private owners who own more than 100 million RMB of fixed assets in China today, and the number will continue to grow if the Chinese government's current policies persist (Chen, 1995).

With the purpose of finding out the extent of losses incurred in the different ownership enterprises in March 1995, a survey was conducted by a provincial bank covering its 182 loanees. The result of this survey shows that state-owned enterprises and collectives account for 91.76 %, while Sino-foreign enterprises, wholly foreign-owned enterprises, Sino-foreign cooperatives and private enterprises only account for 8.24 % (the Research and Survey Centre of CIB, 1995).

Mr Lu further stated that at the present moment, many state-owned commercial banks have started to consider how to get private enterprises with good potential as their long term clients. With the increasing rate of competition among commercial banks, some good private enterprises would become targets sought after by the banks. The barriers preventing bank loans to the private sector will be removed. Loans would flow to those enterprises with good reputations, good payback capability and low risk, regardless of whether they are state-owned, collectively-owned or privately-owned.

In recent years, wholly foreign-owned, Sino-foreign joint ventures and Sino-foreign cooperative enterprises have developed rapidly. They are however still under some constraints and unable to compete with China's national industries in terms of number and strength. At the same time, foreign banks usually only provide services to the foreign invested enterprises and as a result their service and clientele networks in China are limited.

Mr Lu also suggested that the branches of foreign banks should regard those private enterprises with good economic performance as their service target in order to enlarge their business network, although undoubtedly, guarantees for repayment should be in place. Unlike China's state-owned commercial banks most of which are facing this as a

new field, foreign banks have their expertise in this field. More importantly, no clause in the “regulations governing foreign banks” covers provision of service to the private sector. It is clear that servicing the private sector can develop foreign banks’ business activities in China without breaching the regulations set up by the State Council or the People’s Bank of China.

At the interview, Mr Zhou shared a similar point of view with Mr Lu. He added that at present, the economically well developed regions such as the Pearl River Delta, the Yangtze River Delta, the Southern Fujian Delta and Shandong Peninsula, are popular localities for foreign financial institutions, many of which are found operating there. However, the representation and participation within the Chinese financial system is highly biased towards state-owned banks who have been the most active market players for a long time, and this structure seems incongruous to the business activities taking place in these areas. For instance, in Guangdong’s Pearl River Delta region where many enterprises of different forms of ownership are represented-- state-owned, private , share of stock , collective , collective-private joint venture enterprises, wholly foreign, Sino-foreign joint ventures, and Sino-foreign cooperative ones, etc.-- these present a complex task for the state-owned commercial banks to handle. In other words, the solely state-owned banking system could not fit into this multi-ownership structure due to most state-owned commercial banks being unable to provide sufficient funds to support the development of these other-ownership enterprises in view of their limited lending capital, lending ceilings and so on.

According to some Chinese experts¹⁰, the financial industry should be deregulated to allow various ownership schemes to compete with state-owned financial institutions. Shareholding, partnership, joint venture, and private structures should be encouraged so as to speed up the transition of the state-owned specialised banks to a commercial banking role.

¹⁰ Zhang and Li , 1995 see App. A: List of References (Zhang , who is the well-know Professors at the Business School of Jinan University).

Zhou suggested that the inability of the state-owned banks to provide funds for private enterprises or other ownership enterprises is considered as a business opportunity for foreign banks. The foreign banks should focus on main cities, he suggested, as well as the prosperous small and medium cities as prospective segments for business activities. To ensure fast payback and early business breakeven in China, one must be quick in reaping available opportunity. Hence, foreign banks must not hesitate to use an adequate strategy to provide high quality and efficient services to non-state-owned enterprises. While the Chinese state-owned banks are still on their reform path, foreign banks should take advantage of this period to gain a foothold in the Chinese market and to establish their presence and business networks.

From the above, it can be seen that the rapid development of the private sector and other-ownership enterprises can be regarded as one of the opportunities for foreign banks to establish new service networks and enlarge their market occupancy.

5.2.5 The Housing Reform, the Real Estate Industry and the Home Loan Business

From 1949 onward it was made mandatory for the government sector and state-owned enterprises to provide for the welfare of their employees, including housing accommodation, food subsidies and medicare, and even to provide support for the education of their children. In 1992, state-owned enterprises (though not including the government sector itself) absorbed US \$ 7.8 billion in direct subsidies, during the same year when the national budget deficit was US \$ 4.1 billion (Floracruz, 1993). Since the adoption of the market economy, such welfare benefits have been considered as inappropriate and inconsistent with the new system. It seems to have been one of the key factors in causing many state-owned enterprises to lose money. In 1994, with the purpose of pushing state-owned enterprises to adapt to the “socialist market” with higher

economic efficiency, a series of reform measures was announced involving housing, medical insurance, education subsidies and other welfare benefits. Among the housing system reforms, the state-owned enterprises were relieved of the need to provide housing accommodation to their employees. The housing needs of the employees are to be met privately rather than under the care of the state.

According to the survey (see App. B, Questionnaire 1: Q9/b), 80 % of respondents believed that new business opportunities will result from the reform of the housing system. This is because the housing reform will bring about a great advance in China's real estate industry. Yet the home loan business is just at the initial stage in China, and these respondents suggested that the home loan business should be encouraged if the Chinese government intends to develop its real estate industry. The remaining 20 % of respondents felt that it has been impossible to popularise the home loan business rapidly in recent years, because it is difficult to ensure repayment without a comprehensive law for mortgages on real estate. However, these remaining respondents also recognised that the real estate industry and home loan business have appeal and high market potential for both Chinese banks and foreign banks, as well as real estate investors.

Mr Chen, the Chief of Real Estate Department of the People's Construction Bank of China, Guangdong Branch, and Mr Vincent, a Manager at the NanYang Commercial Bank, expressed confidence in the future of the real estate market the interviews. Mr Chen stated that China has a population of 1.3 billion with, at present, a huge demand for housing accommodation. Nevertheless, the Chinese real estate industry is relatively young and underdeveloped and has a short history. As compared with the developed countries, China's real estate market activity is just at the beginning stage, the real estate industry generally is located in the Economic Special Zones and coastal cities, and the investment structure was unreasonable due to the oversupply of luxury housing. However, this scenario is beginning to change toward a more active consumer market with the establishment of real estate laws and regulations and the adjustment of the investment structure. For example, many local and foreign real estate companies are

developing cheap accommodation to meet the affordable standard and the need of consumers. It is believed that the real estate industry has high market potential as China's economy progresses to a more active level, bestowing higher earnings and higher national income.

Mr Chen noted that the development of the real estate industry must be based on the development of the home loan business. Yet home loan operations in China are still underdeveloped. Previously the People's Construction Bank has been the one and only bank to provide 7-year instalment credit for purchasers. The potential of the real estate industry and home loan business have been gradually recognised by other commercial banks. However, they are faced with the difficulty of how best to exploit such business opportunities as they lack the experience to do so. Some commercial banks entered into this market not as a business strategy for growth but merely as an ancillary service to attract more personal savings accounts. Such banks require a minimum deposit balance in the account before a loan could be approved.

Similarly, Mr Vincent expressed great interest in this area during the interview. He stated that foreign banks with their vast experience in real estate lending and services should make use of this opportunity to deepen their market penetration. Nan Yang Commercial Bank has a considerable level of experience in this field. As mentioned earlier, "Mortgage" product and service were popularised by them in 1982 and by this means they have gained a strong foothold in the Chinese market. In promoting this product and service, they cooperated with the Legislative Authority of Shenzhen to establish the first set of regulations for real estate mortgage in the city. Understandably due to the young market and the inexperience of the Chinese population with these products and services, it is necessary for the foreign bank branches to progress with great caution, for example demanding collateral and tight conditions to ensure profitable transactions.

From the above, it can be seen that the housing reform should increase the demand for accommodation. The developing Chinese real estate industry and the real estate market

might offer an opportunity to both local and foreign banks to add another product - home loan business.

5.2.6 Key Projects Finance and Syndicated Loans

Dipchand, Zhang and Ma stated (1994) that:

“foreign banks had few opportunities to ‘carve out’ niches from the investment program in the Chinese economy. China is a large country, and the idea of economic restructuring conjures up visions of massive projects requiring large sums of money. While this may be true of China, investment was controlled according to a unified plan. Whatever financing foreign banks had to offer, this had to fit within that unified plan and it normally required close contacts with the Chinese fraternity. Very few foreign banks had such contacts, having been there only for a short time. The second complicating factor was that foreign banks had to compete with the Bank of China which had ample foreign exchange to finance projects within the unified plan. This could not be an easy task considering that BOC could lend at concessionary terms. The third complicating factor was that the Chinese economy was easy to overheat and when this happened, the state had very little remorse in applying austerity measures which include reduction in investment and even the cancellation of projects”(pp 185 - 186).

Moreover, there were other factors contributing to the low level of loans activity of the foreign banks such as China rejoining the World Bank as a member of the Third World, qualifying for soft loans, developing China’s own institutions and using them to raise funds in the international financial market, and the increasing number of joint venture leases, financial companies and so on.

Are the above factors still in existence and has this difficulty been reduced? In answering this question (see App. B. Questionnaire 1: Q 11) in this survey, Sophie, Jack Xie and

Zhang (a senior manager at the People's Construction Bank of China) share the same views and all considered this difficulty is being reduced gradually, with the growth of China's economy and more and more foreign bank branches getting closer to the Chinese authorities and local customers. Of course, some of the above factors which caused difficulty to the foreign banks seeking opportunities in China's construction industry still exist and seem impossible to remove easily. Recently, however, things have changed, and many foreign bank branches have more opportunities to participate in financing China's key construction projects.

Zhang noted that the People's Bank of China is considering allowing foreign banks to engage in some big construction projects such as highway, bridge, mine, energy, communication, environment protection and high technology agricultural projects due to the inability of the state-owned banks to provide sufficient funds to meet the needs in infrastructure and key agricultural projects. According to the "The Suggestion to Formulating the Ninth Five-Year Economic Development Plan (1996-2000) and A Long-Range Object for the Year 2010" adopted at the Fifth Plenary Session of the Fourteenth Central Committee of the Chinese Communist Party on September 28, 1995, the Chinese government will focus on the development of agriculture, water conservancy facilities, energy, transportation, communication and high technology etc, meanwhile encouraging foreign enterprises to participate in China's core economic construction projects. It could be predicted that foreign bank branches will have more opportunity to be involved in China's construction industry in the coming 15 years.

Sophie noted that the Banque Indosuez enjoyed good results from participating in several of China's core projects in the past several years. They provided loans and successfully raised medium and long-term funds from European countries (including France, Italy, Belgium, Britain and Holland) and Hong Kong, United States and Japan by means of government credit and syndicated loans. The proceeds of such loans are used to support many projects, including some key state construction projects such as the Shanghai

Petrochemical's 300,000 Tons polyethylene plant and the Guangdong Daya Bay nuclear power house projects.

According to Sohpie's experience, she suggested that indeed, there are many difficulties encountered by foreign banks in their operations in the Chinese market. However, in order to gain favourable treatment in business activities and to engage with ease in the Chinese construction industry, foreign bank branches themselves should build up good relationships with the People's Bank of China, and relationships with other authorities and local counterparts also should be well coordinated.

Jack Xie stated that many foreign bank branches have become more and more involved in China's construction industry, including some French banks and American banks such as Société Générale and Chase Mahattan which have advantages and good performance in project financing and syndicated loans. These foreign banks have played important roles in financing many large projects, in power, petroleum, mining & metals, aerospace, shipping, telecommunications, chemicals and so on, and the customers were both locals and foreigners.

Clearly, foreign bank branches will have more opportunity to participate in China's core economic construction projects in future years, owing to the Chinese government focusing on the development of agriculture, high technical industry and infrastructure construction in the coming 15 years.

5.2.7 Development of the Insurance Industry and the Opening of China's Insurance Market

The development of the insurance industry in China has attracted a lot of attention since "reform and opening" in 1980. According to the statistical data of the People's Bank of

China, premium income has increase 200 times since then, higher than the world average increase. This is however in contrast to the main index identifying the level of the nation's insurance industry: the average premium per head is less than US \$ 5, premium income as a proportion of GDP is 1 %, and the percentage of life insurance and the variety of insurance products are behind many nations in the world (Qian, 1995).

Since 1995, the Chinese government has pushed the pace of the social welfare system reforms, through establishing and perfecting the new unemployment insurance, medical insurance, and pension insurance systems in order to meet the needs resulting from the reform of the state-owned enterprises. The survey results (see App. B, Questionnaire 1: Q10) show that all interviewees and respondents believed that the reform of the social welfare system would increase the variety of insurance and services for both domestic and foreign insurance companies in China.

Audrey Chong, General Manager for the Asia Pacific Region at the Colonial Mutual Group, states in my interview with her in Melbourne that in comparison with the insurance system in developed nations where insurance products are available for a full range of financial needs, there are many "empty spots" in China's insurance industry. It is believed that the Chinese insurance industry has a higher market potential that attracts the interest of many insurance companies around the world. Following the entry of foreign banks, overseas insurance companies blow the second wave of "financial heat" in China. Opening up the Chinese insurance market to the outside world took place only one step later than the banking market. In early 1994, the People's Bank of China initially promised to allow foreign insurance companies to operate part of the insurance business involving foreign currency settlement in the Special Economic Zones and coastal cities. By late July 1994, there were 66 representative offices of foreign insurance companies in China, some of which are American International Assurance Company Ltd. (AIA) and Morgan of the United States, Tokyo Marine of Japan, Sedgwick Chartered of Britain and so on. National Mutual of Australia has established several representative offices in cities such as Beijing, Shanghai and Guangzhou.

In the case of Colonial Mutual Group, in order to research potential co-operation and business opportunities and build long-term relationships, the Group has set up two representative offices in Beijing and Shanghai. These two offices will liaise with the Chinese authorities and government agents and build on their relationships with locals. In other words, the commitment of these offices is to try to obtain key operating licenses so that they can enter the Chinese insurance market as soon as possible.

Audrey Chong believed that foreign insurance companies will gain benefits from China's insurance market by means of their strengths in such areas as insurance services, people management skills and computer systems expertise, once the Chinese government allows foreign insurance companies and insurance carriers entry into China's market.

For the protection of the interest of the Chinese insurance industry, undoubtedly full opening of the Chinese insurance market to foreigners will be impossible. However, as the first trial city open to foreign insurance companies, Shanghai became a place for many foreign companies to compete, and some foreign insurance companies such as AIA have gained economic benefits from their life insurance operations. Recently the People's Banks of China has decided to extend the trial cities from Shanghai further to Shenzhen, Guangzhou, Beijing, Tianjin and Dalian. Moreover, the Insurance Law has been adopted by the Eighth National People's Congress in July 1995, and it is likely that the entry of foreign insurance companies will be permitted and protected by this law.

I had a further interview with Mr Li, Assistant Manager of the International Department at the People's Insurance Company of China, Guangdong Branch in Guangzhou. Mr Li stated that the world insurance business is mainly divided into life insurance and non-life insurance. On the other hand, in the Chinese insurance industry there is no such differentiation. Until recently, the People's Insurance Company of China, the state insurance monopoly, is said to have had the widest range of insurance products; however, it has not provided life insurance products.

China is a country with a population of 1.3 billion, which creates a great demand for pension insurance, a point which can be proved by the following statistics:

Firstly, the proportion of aged people in China has increasingly expanded. In 1985, people over 60 years of age accounted for 7.6 % of the total population while this figure will increase to 8.9 % in 1995. It is predicted that the figure will climb to 9.8 %, which is approaching the standard of an aged society, 10 %, by the year 2000. In the past 14 years, the retired staff and workers in the country increased by 29 percent annually and there would be 150 million retired people in China by the year 2030. In 1982 the pension insurance premium was RMB 5 billion. It rose to 69.4 billion for 1992, and 74 billion for 1993.

Secondly, there is pressure from the labor market. There are 800 million underemployed people, of whom 130 million are rural underemployed who need to be redeployed. New job seekers in urban areas increased by over 10 million every year, while 15 million redundant staff within the state-owned enterprises need to be re-deployed. The social welfare expenditures for this item alone will exceed RMB \$ 200 billion although the current expenditure for the provision of unemployment insurance is only RMB \$ 2 billion. Only one-fifth of China's population bought personal insurance, one-third of the workforce participated in pension insurance, 7 % of households in property insurance, and the per capita insurance premium is only some RMB 40 (approximately US \$ 5), by contrast with the developed countries such as the United States and Japan where this figure is as high as US \$ 2000-3000(Source: the statistics of the People's Insurance Company of China 1995).

At present the domestic insurance companies have been challenged by several foreign insurance companies which have been allowed to establish their operations in China. The entry of these foreign insurance companies into the Chinese market, with their excellent quality of service and full range of insurance products, has made an impact on the undeveloped service and management systems of the domestic insurance industry. For

example, there are more than 1200 agents of AIA working in the Shanghai life insurance market. Owing to their excellent service skills, the business of AIA in Shanghai has expanded rapidly.

Clearly the undeveloped life insurance and non-life insurance business in China will provide a great potential market for the foreign companies who have obtained rich experience in this areas. The gate of the Chinese insurance market has been opened to foreigners gradually, and it is necessary for foreign insurance companies to design adequate strategies and sound operating policies to seize this new business opportunity in China's insurance market.

5.3 New Challenges for Foreign Banks in China?

As noted earlier, China's regulatory framework for foreign banks is restrictive. Many interviewees from the foreign bank branches complained (see section 5.2) that the foreign banks' business scope, locations, customer base and so on are restricted by a set of strict regulations. In addition to the restrictions imposed by the Chinese government, there are other challenges faced by foreign banks. As Zhang and Zheng (1993, p29) stated, these include inefficiency of the Chinese government authorities and companies involved, regulatory laxity and difficulties in risk assessment.

However, according to this survey (see App. B, Questionnaire 1: Q12 and Q13) 40 % of the respondents and interviewees who were from domestic banks did not believe that the current and future Chinese economic and financial reforms would create new challenges or difficulties to foreign financial institutions, although they believed that the business scope of foreign banks would still be relatively limited in comparison to local banks. They stated that the interests of Chinese banking of course must be placed first.

At the moment, the commercialisation of the Chinese banks is just at the beginning stage and it is necessary for the People's Bank of China to use regulation to protect the interests of the local banks. Recently, the People's Bank of China has announced that it will gradually relax restrictions on foreign bank business, such as scope and location, and in particular the PBOC has decided to select two cities (Shanghai and Guangzhou) as the place where an experiment is to be made, for foreign banks to engage in renminbi business. Several foreign bank branches will be selected by the PBOC to be involved in this operation. The experience from this experiment would be passed on to all foreign bank branches after the trial has gained results. It has become clear that the second stage of China's economic and financial reforms would bring opportunities to foreign banks as well as challenges or difficulties. It can be said that the foreign banks are the beneficiaries from China's program of economic reform and opening of the financial market.

One interviewee from the People's Bank of China Shenzhen Branch and all interviewees from the foreign bank branches believed that there will be opportunities and new challenges or difficulties faced by the foreign banks under the new circumstances, although further financial reform would reduce some of the preexisting difficulties for foreign banks such as business scope, locations and regulatory laxity, etc. A summary of interviewees' points view is shown below.

5.3.1 New Competition

Jack Xie noted that competition in the Chinese financial market should be increased by the implementation of further financial reform. The intense difficulties would be between domestic banks and foreign banks after the state-owned specialised banks completely transform themselves into commercial banks and the foreign banks are allowed to do local currency business.

According to the “Commercial Banking Law of the People’s Republic of China” a commercial bank operates independently, takes responsibility for all risks it may encounter and for its own profits and losses, and exercises self-regulation on the principle of economic efficiency, safety and liquidity.

At the moment, the state-owned banks are quickening their pace of development toward becoming competent and efficient commercial banks by enhancing their level of service, reinforcing their financial strength and adopting new technology and management methods, so that they really play the role of commercial banks in the Chinese financial market. It is clear that the competitive advantages of foreign banks in service skills and banking management would be much weakened after the Chinese commercial banks have upgraded.

Moreover, it is difficult to overcome the fact that the Chinese banking industry was monopolised by four major commercial banks (the Bank of China, the Industrial and Commercial Bank of China, the Agricultural Bank of China and the People’s Construction Bank of China). These banks hold nearly 80 % of the total asset value of all Chinese state-owned banks (according to the official estimate, the total assets of all Chinese commercial banks is about RMB 3000 billion) with their dense service networks which spread all over the country. Obviously, under the situation of monopoly, it is impossible to form a fair competitive market system. Therefore, the foreign banks would be faced with unfair competition when they are able to deal with local currency business.

Mr Lou, an Economist at the People’s Bank of China, Shenzhen Branch, stated that the new competition will not only be between local banks and foreign banks, it will also be among the foreign banks. As we know, the number of foreign bank branches has increased since the early 1980s, and the numbers are on the rise. The competition among the foreign banks has become sharper and sharper in China’s Special Economic Zones and in the coastal cities with many foreign bank branches involved in the Chinese

financial market. Many foreign banks such as those of the United States, Japan, Hong Kong, Britain, France, Germany and other countries adopt their own aggressive marketing strategies and use their remarkable ability to compete against other foreign counterparts in expanding their market share in China. These foreign bank branches are trying in every possible way to promote their products and services to both local and foreign customers, and actively participate in China's key construction projects.

It is clear that competition will become even more intense after foreign banks are allowed to enter the local currency market. Thus, under the new circumstances, a foreign bank branch which wants to gain satisfactory performance in China must design a set of sound business strategies, understand the development of both local and foreign counterparts and have a good grasp of market information. In other words, a foreign bank branch must have comparative advantages against other competitors.

5.3.2 Default on Obligations and Credit Risk

As everyone knows the Chinese government is faced with a serious "bad debts" problem. The conflict between the old regime (the planned economic model, the ownership of the state-owned enterprises, etc) and the market economic system is the key factor which is causing default on payment of goods or obligations in many enterprises. Many Chinese state-owned banks are also suffering from bad debt problems due to unclear property rights between the banks and state-owned enterprises. From those banks, Chinese enterprises took loans with no thought of ever repaying them.

Philippe Bo, Assistant Manager of Operations and Administration at Banque Nationale de Paris, Guangzhou Branch, strongly believed that the credit risk would increase with the expansion of operations and service networks. This was because the traditional planned economic model had led to many borrowers (such as state-owned enterprises and collective ownership enterprises) lacking any sense of credit repayment. Although the "Corporation Law", the "Credit General Rule", and other relative regulations have

been enforced, default on repayment of credit still happens due to inexperience and ineffective systems for executing laws. Moreover, China has had several thousand years of history as a nation with a centralised system, ruled by a few people who are in power or a supreme leader, but not ruled by laws. As a result, most common Chinese people cannot conscientiously observe the laws and regulations owing to the nation's lack of a legal sense.

However, credit risk can be averted if a bank has built a team of specialists who are able to assess project risks. As Ms Feng, an Officer at the Administration Department for Foreign Financial Institutions, at the People's Bank of China, Guangdong Branch, noted, some foreign bank branches have no bad loans after more than a decade in China. This is because they have effective methods for appraising projects and managing credit.

Undoubtedly, foreign bank branches should adopt effective measures to take precautions against bad debts and to manage credit risks before they are permitted to enter into the local currency business.

5.3.3 Human Resource Management and Management Style

Sophie noted that there are other new challenges such as the turn-over of employees and the problem of localising the management. These challenges are faced by the increasing number of foreign banks as further opening of the Chinese financial market to foreigners takes place. Generally, the local Chinese staff of foreign bank branches have good qualifications and strong specialised skills. Most of them came from the Chinese banks and were capable staff in these banks. This group of people is in the good graces of foreign financial institutions. They have more opportunities to select their employers and their jobs with the increasing number of foreign financial institutions in China. In other words, foreign bank branches easily lose their more capable employees to other

foreign banks or foreign financial institutions which offer higher positions and salaries and better professional and social welfare conditions.

Another challenge which will be faced by foreign bank branches seems to be the culture differentiation between overseas and local employees. Generally, the top ranks of management of the branches are from their home countries, and the management methods and regulations and disciplines mostly follow those of their headquarters, but Chinese people possess many characteristics that are difficult for Westerners to understand. So these disciplines and regulations cannot be fully followed by the local staff.

5.4 Conclusion

From the above, it would appear that there are differences between the views of employees of foreign banks and the state banks on issues related to the second stage of Chinese financial reforms and the increased opportunities for foreign banks.

The staff of foreign banks considered that the second stage of reforms has not fully opened up the Chinese financial market to foreigners, the controls on operations of foreign financial institutions are still strict, and the scope of their business activities is limited. Some staff of foreign banks also complained that there is unfair competition between the local Chinese commercial banks and foreign banks, and the business activities of foreign banks are limited by both written and unwritten provisions. Some foreign banks requested that they could enjoy the same national treatment as the local Chinese banks in the country.

However, the staff of Chinese state banks considered that although foreign banks cannot engage in the domestic banking business at the moment, the foreigners could enjoy some forms of preferential treatments, in other words, foreign banks could enjoy “better than

national treatment” on taxation. Foreign banks possess advantages in many aspects, such as sufficient capital, variety of banking products, qualified bankers, and sophisticated managers and banking systems and so on. The Chinese commercial banks would lose their dominant positions in the Chinese financial market if both existing written and unwritten provisions were removed. In order to protect the interests of local Chinese banks, it is not possible to completely open up the Chinese banking industry to foreigners, and it is necessary to have reasonable limits on the business activities of foreign banks.

Although there are some contrary views and comments between the employees of foreign banks and the state banks, almost all of them believed that the second stage of Chinese financial reforms would create a smooth market situation and potential business opportunities for foreign financial institutions in future years. These opportunities seem to be appearing in the follow areas; building up customer connections; expanding clientele networks and increasing market shares; engaging in the home loan business; becoming involved in financing key Chinese national projects and in syndicated loans; entry into the Chinese insurance market and so no.

However, foreign financial institutions are facing some new challenges or difficulties under the new circumstances, although further financial reforms would reduce some of the preexisting difficulties for foreign banks such as business scope, locations and regulatory laxity, etc. The new challenges or difficulties might be as follows: there would be new competition between domestic banks and foreign banks; credit risk would increase; there would be increasing difficulties in human resource management, etc.

In short, the second stage of China’s economic and financial reforms would bring opportunities for foreign banks as well as challenges or difficulties. The foreign banks are the beneficiaries from China’s program of economic reform and opening of the financial market.

6. COMPARATIVE ANALYSIS OF THE BUSINESS STRATEGIES OF FRENCH AND AUSTRALIAN BANKS IN CHINA

According to my survey, under the strained operating circumstances, many foreign bank branches are performing well in the Chinese financial market with their excellent business skills, quality service, and aggressive market strategies. For example, Japanese banks were the pioneers in the development of China's financial market. The Export - Import Bank of Japan was the first overseas bank to be allowed to open a representative office in Beijing in 1979. In 1995, the Bank of Tokyo became the first foreign bank to gain a license to set up a branch in Beijing, China's political centre. The Japanese have set up the strongest presence for their overseas financial institutions in China with their superior financial technology and aggressive marketing.

The business activities of American banks have also developed rapidly in China. One of their successful business development strategies is to promote a full range of financial products in China. Americans are actively increasing the number of their pure banking operating institutions, while they also attach importance to developing non-banking business activities. According to the People's Bank of China, America is the only country which provides a satisfactory variety of products and financial operating institutions of all kinds. America has established many non-banking financial operating institutions in China, such as investment companies, securities companies, leasing companies, finance companies and insurance companies and so on.

French, British and Hong Kong banks also have achieved satisfactory performance and good reputations with their rich experience in the international banking industry.

However, unlike other Australian industries which are strengthening their operations or cooperative undertakings in China, in respect of their number of operating institutions in

the Chinese financial market Australian banks seem to be behind the foreign banks mentioned above.

Clearly it is important to examine the business strategies of Australian financial institutions. Thus, this chapter intends to compare the strategies and policies of French and Australian banks in order to help Australian financial institutions understand the major problems and barriers that they will encounter in developing their business activities in the Chinese financial market.

Questionnaire 2 (see App. B,) was designed to explore the type of strategies adopted by the Australian and French banks in their business operations in China. It has been sent out to 2 Chinese banks and 9 French and Australian financial institutions which are located in the three selected major cities --- Shanghai, Guangzhou and Shenzhen. The response rate to the mail questionnaires was 60%. Interviews were conducted at one Australian financial institution in Melbourne and four foreign financial institutions and two Chinese banks in Guangzhou and Shenzhen.

Although the respondents and the interviewees could not give detailed information in answering the Questionnaire, the survey results show the distinction in business strategies and operating policies between the Australian and French banks. The results of this comparison will be presented in the following part of this chapter.

6.1 Overview of French Banks' and Australian Banks' Entry Into China

As mentioned in the above, in 1979 the Export-Import Bank of Japan opened a representative office in Beijing after China decided that representative offices of foreign bank could be set up in the country. This unprecedented act brought this opportunity to the attention of others in the same trade or business. After a wait-and-see attitude for a

short time, there were over 70 foreign banks, one after the other, applying for licences to open offices in early 1981. During the first three quarters of 1981, 19 were approved.

Table 6-1 below shows foreign banks' representative offices in China, as of October 1981:

Names of Banks	Home Country	Status	Location
Bank of East Asia	Hong Kong	Branch	Shanghai
Bank of Tokyo	Japan	Representative Office, Liaison Office	Beijing Guangzhou
Banque Nationale de Paris	France	Representative Office Liaison Office Liaison Office	Beijing Guangzhou Shanghai
Barclay's Bank International	United Kingdom	Representative Office	Beijing
Canadian Imperial Bank of Commerce	Canada	Representative Office	Beijing
Chase Manhattan	United States	Representative Office	Beijing
Commerzbank	Germany	Representative Office	Beijing
Crédit Lyonnaise	France	Representative Office	Beijing
Deutsche Bank	Germany	Representative Office	Beijing
Export-Import Bank	Japan	Representative Office	Beijing
First National Bank of Chicago	United States	Representative Office	Beijing
Hong Kong-Shanghai Banking Corp., Ltd.	United Kingdom	Branch Representative Office	Shanghai Beijing
Industrial Bank of Japan	Japan	Representative Office	Beijing
Midland Bank	England	Representative Office	Beijing
Overseas Chinese Banking Corp	Singapore	Branch Branch	Shanghai Xiamen
Royal Bank of Canada Corp	Canada	Representative Office	Beijing
Société Général	France	Representative Office	Beijing
Standard Chartered Bank	United Kingdom	Branch	Shanghai

Source: the People's Bank of China

The above table shows that there were three French banks among the first group to be allowed to open representative offices in China. Worth mentioning is the fact that the Banque Nationale de Paris (BNP) was the first foreign bank to set up liaison offices in

Guangzhou and Shanghai, in addition to their representative office in Beijing. And then, BNP swiftly established another representative office in Shenzhen. BNP had a longstanding presence in China which started in 1860. When this bank reentered into China's market, it tried in every possible way to search for business opportunities and to develop its operations and rebuild a comprehensive network in China.

In 1982, Banque Indosuez was allowed to open two representative offices in Beijing and Shenzhen. Then this bank established two other offices in Guangzhou and Shanghai in the period 1984 - 1986. Banque Indosuez has continuously existed in China for more than 90 years. In 1898, the first branch was opened in Shanghai, then seven other branches were established in Guangzhou, Hankou (Wuhan), Shenyang, Beijing, Tianjin, Zhanjing and Kunming. After 1949, these branches were closed one after another. After 1956, the Shanghai branch became only a clearance office.

The French banks have been active in China's economic construction and the country's key projects since they entered or reentered into China. Société Générale, BNP, Banque Indosuez and Crédit Lyonnaise have achieved remarkable performance in syndicated loans, and raised funds from Europe and other countries for China's enterprises. In particular, they have organised customers from their home country or other overseas countries to investigate the Chinese investment environment and encouraged them to invest in China. The activities of French banks left a good impression on Chinese authorities and the Chinese banking industry. It seems to have helped these French banks to have had a good beginning to their operations in China.

In 1985, Banque Indosuez was allowed to upgrade the Shenzhen Representative Office to branch status. Soon afterwards, BNP and Société Générale also were permitted to upgrade their offices to branches. In 1991, two other branches - Banque Indosuez, Shanghai Branch and Crédit Lyonnaise, Shanghai Branch - were allowed to establish.

After being in China for 14 years, the business of French banks has greatly expanded and they have settled into a strong presence in China, mainly through branches, operating subsidiaries and representative offices in 9 coastal cities and Special Economic Zones.

At interviews, several managers at the BNP and Banque Indosuez Guangzhou Branches mentioned the need to well understand the Chinese economic environment, Chinese culture and the specific needs of their customers before undertaking rapid business expansion in China's financial market. Their early entry into China's financial market of course is another factor especially relevant to explaining the fast growth of the business activities of the French banks. At an interview, however, Jack Xie pointed to the peculiarities of the French banks' strategies compared to those of their major foreign competitors. For example, in developing their services, French banks have adopted a focused approach. They are focusing on project finance, corporate finance and inter-bank service. Several French banks, especially Société Générale and Banque Indosuez, are playing leading roles in the wholesale business of foreign banks.

In the case of Australian banks, however, they were in an unfavourable position as compared with French banks, owing to the fact that French banks have some competitive advantages in their business activities in China. One of the main competitive disadvantages of Australian banks seems that they have not been forming a truly comprehensive network in China. The Australian banks' entry into China was in 1986, 5 years later than the French. In other words, when Australian banks were allowed to open their representative offices, French banks had already established several branches or joint venture financial institutions in Special Economic Zones or other coastal cities. Of course, their later entry into the Chinese financial market seems to be another competitive disadvantage for Australian banks.

Clearly, it is important to learn from the experience of their major foreign competitors, such as French banks, if Australian banks want to capture a share of the fast-growing Chinese financial market activity.

6.2 Location of Presence

The number of branches, operating subsidiaries and offices abroad appear to be a very rough indicator of the international involvement of a banking system. A strong regional (or foreign) presence of foreign banks has often been regarded as crucial to the success of their geographical extension and development of business activities. The following figures show the physical presence of both French and Australian banks in China.

Table 6-2 The location of Representative Offices of French and Australian Banks in China

Location	Number of representative offices of French banks	Number of representative offices of Australian banks
Beijing	7	4
Shanghai	3	1
Guangzhou	4	1
Dalian	1	
Shenzhen	1	
Tianjin	1	

Note: Up to the end of 1995 (Excludes non-bank financial institutions. Source: Statistics of the People’s Bank of China).

Table 6-3 Branches of French and Australian Banks in China

Bank	Location	Number of Branches
France		
Crédit Lyonnaise	Shanghai, Xiamen, Guangzhou	3
Banque Indosuez	Shanghai, Shenzhen, Guangzhou	3
Société Générale	Shenzhen, Guangzhou, Tianjin	3
Banque Nationale de Paris	Shenzhen, Tianjin, Guangzhou	3
Australia		
ANZ	Shanghai	1

Note: Up to the end of 1995.

Source: Statistic of the People’s Bank of China, Banque Indosuez and BNP. (BNP has a banking subsidiary in Shanghai, in partnership with the Industrial and Commercial Bank

of China: The International Bank of Paris and Shanghai. Banque Indosuez has a non-bank subsidiary in Guangzhou, in partnership with the Industrial and Commercial Bank of China: Industrial and Commercial International Leasing Corp. Ltd.)

From the above figures, it would appear that the French banks, especially the four internationally most active French banks which were mentioned in Table 5-3, have achieved good results in expanding their business activities in China. After 14 years in China, French banks are active throughout the country with a network of branches and offices in 7 large Chinese cities. The number of branches in China has been regarded as a most important strategy for the four internationally most active French banks in completing their comprehensive networks in the Asia Pacific region, in order to expand their international activities. Thus, these banks are seeking the opportunity to enter into the other Chinese cities, positioning themselves for more business.

At interviews, Ronald Jim and Sophie stated that the French banks not only concentrated their efforts in the city of Shanghai - China's future financial centre - but also focused on other cities where the success of foreign enterprises or the fast growth of the regional economy required trade finance and foreign currency loans. In other words, French banks not only provided financial services to their clients who came from their home country, but also devoted their attention to providing the full range of commercial banking products to their global clients, including locals. Indeed, besides Shanghai, four French banks have opened their branches in Shenzhen, Guangzhou, Tianjing, and Xiamen. (Guangzhou and Xiamen were the economically well-developed and most active market economy areas in China. Tianjing is a thriving port city and more and more multinational corporations have moved there). Currently, several French banks are looking at other cities, such as Dalian and Qingdao, the north China coastal cities. The areas surrounding these cities have become key epicentres for foreign direct investment.

The above tables show that there were 6 Australian bank representative offices in China (National Australia Bank, ANZ, Westpac and Commonwealth Bank, each bank having

one office in Beijing and ANZ having another one in Guangzhou, Commonwealth Bank having another office in Shanghai) and one branch - ANZ Shanghai Branch. According to an officer of the People's Bank of China, ANZ Shanghai Branch has a good reputation in the Shanghai financial market. Its business activities have also developed rapidly in more recent times.

The performance of Australian banks in China might be considered satisfactory, yet compared to the physical presence of French banks, Australian banks appear to be in an unfavourable position, owing to the fact that their geographical coverage is limited while the French banks have relatively extensive networks in China.

However, in the case of insurance companies, it is a different story. According to the statistics of the People's Bank of China, by the end of 1995 there were 5 representative offices of Australian insurance companies in China. Among these National Mutual has opened 3 offices in Beijing, Shanghai and Guangzhou, and Colonial Mutual has an office in Beijing and Shanghai. But only one French insurance company - Gan Assurances - has established an office in Beijing.

6.3 Scope of Business Operations and Business Focus

6.3.1 Scope of Business Operations

As mentioned above, the scope of business operations of foreign banks is limited by the "Regulations Governing Foreign Banks and Joint Chinese-Foreign Banks in Special Economic Zones of the People's Republic of China" and other banking laws. According to the "Regulations Governing Foreign Banks and Joint Chinese-Foreign Banks" there were 12 banking operations in which foreign bank branches were allowed to be engaged partially or totally. Generally, based on an application submitted, the People's Bank of

China may grant its approval to a foreign bank to engage in some or all of the 12 items of business operations.

The following table shows the scope of business operations for Banque Indosuez Shenzhen, Guangzhou and Shanghai Branches and ANZ Shanghai Branch.

Table 6-4 Scope of Business operations: a comparison between Banque Indosuez & ANZ

A foreign bank branch may engage in some or all of the following businesses	The business operations which have been engaged in by Banque Indosuez	The business operations which have been engaged in by ANZ
Granting loans in foreign currencies and discounting bills	Yes	Yes
Inward remittances from foreign countries, and collection of foreign exchange	Yes	Yes
Settlement of export transactions and outward documentary bills	Yes	Yes
Exchange in foreign currencies and foreign currency bills	Yes	Yes
Foreign currency investments	Yes	No
Foreign currency guarantees	Yes	No
Foreign currency deposits	Yes (for Shenzhen Branch)	No
Trust, safe deposit box, credit investigation and consulting services	Yes	No
Outward remittances by overseas Chinese enterprises, foreign enterprises, Sino-foreign joint-venture enterprises, Sino-foreign cooperative enterprises, settlement of import transactions and inward documentary bills	Yes	Yes (excluding overseas Chinese enterprises)
Foreign currency deposits and overdrafts of the enterprises mentioned above, by foreign nationals, overseas Chinese and so on	Yes	Yes
Buying and selling of stocks and securities	No	No
Handling foreign exchange deposits and loans in foreign countries and Hong Kong and Macao	Yes	No

Source: Banque Indosuez Guangzhou Branch, ANZ Shanghai branch.

The above Table shows that the scope of business operations of Banque Indosuez seems to be wider than ANZ's. Although we lack precise statistical information about the size of Indosuez branches or the ANZ branch in China, we could estimate that the size of their branches might be similar. According to the responses (see App. B, Questionnaire 2: Q5), by the end of September 1995, leaving aside the Shanghai Branch, the Banque Indosuez China area headquarters employed more than 60 people, the Banque Indosuez Guangzhou Branch and Shenzhen Branch hired about 35 and 40 employees while about 38 employees were hired by ANZ Shanghai Branch. Moreover, the People's Bank of China (PBOC, 1990) required that all foreign bank branches and joint venture banks have a minimum registered capital base of 30 million US dollars, and have a minimum operational capital of 10 million US dollars.

Clearly, the French banks have an advantage in providing a wider variety of banking products to their customers compared with Australian banks.

6.3.2 Business Focus

At interviews, Sophie and Jack Xie noted that wholesale business (such as trade finance, project finance, corporate finance and inter-bank service) is a more profitable business for foreign banks in the Chinese financial market. Unlike other foreign banks which had emphasised trade finance services, the French banks have also concentrated their efforts in other wholesale banking areas, namely project finance and corporate finance.

In developing their business activities in China, the French banks have adopted a focused approach. It is selective both in term of the clients they support and the industries in which they provide finance. As Sophie stated, one of the basic strategies for French bank branches is to concentrate on certain core infrastructure industries, such as power, petroleum, transport facilities, aerospace, energy, chemicals, telecommunications and so on.

As mentioned previously, the French banks have achieved satisfactory performance in project finance and corporate finance. The French banks, especially Banque Indosuez and Société Générale, have emphasised providing medium-term and long-term funds to core infrastructure industries, unlike other foreign bank branches which have paid more attention to short-term finance. In other words, the branches of French banks have become involved in many key Chinese construction projects and are playing important supporting roles in China's economic development.

However, according to the mail survey results (see App. B, Questionnaire 2, Q11), the ANZ Shanghai Branch has not become involved in any key Chinese construction projects since they entered into China.

6.4 Strategies and Approaches

According to Chinese financial experts, the key to foreign banks' business success is to design a set of adequate strategies and sound operational policies. These strategies and policies should include assessing the Chinese political and economic climate, gaining better understanding of the Chinese financial system and relevant policies, localising management, providing efficient and high quality services, gaining good business connections or rapport with the Chinese authorities and Government agents, and forming partnerships with local financial institutions, and so on.

In this survey, the respondents from the French Banks and the Australian bank were asked to rank in order of importance, which strategies they think would help their institution have success in the Chinese financial market (see App. B, Questionnaire 2, Q10).

Some survey data is shown in the Table 6-5.

Table 6-5, Ranking of Strategies

Strategies	Ranked by ANZ Bank Shanghai Branch	Ranked by Banque Indosuez Guangzhou Branch	Ranked By BNP Guangzhou Branch
To localise your management	1	3	3
To be good at dealing with the Chinese authorities and government agents	4	1	2
To be good at taking advantage of the imperfections of the Chinese financial regulations & system	5	5	4
To be politically sharp and better understand the current policies	6	4	7
To provide efficient and high quality services to customers	2	2	1
To be flexible and often adjust your strategies to fit the political and economic climate	7	7	6
To build up cooperative relationships with local financial institutions	8	8	8
To have location advantages	9	9	9
To put trust in local staff and pay attention to improving their skills	3	6	5

(Survey conducted in October 1995)

Table 6-5 indicates that there is little difference in perception between the respondents as to which strategies are the most important. The interview results also show that there were differences in market strategies and business approaches between the French and

Australian banks in China. Several managers from French bank branches considered that for multinational banks to survive and make profits in a foreign country, they must have competitive advantages, such as superior financial technology, aggressive marketing, and so on. In the case of the Chinese market, aggressive marketing seems to be the most effective competitive advantages that foreign financial institutions employed in making profits.

At interviews, Sophie noted that a successful banking strategy for foreign banks in China must be one in which opportunities are seized and risks are avoided. In other words, a foreign bank branch should actively seize business opportunities without going against the regulations of the People's Bank of China, not just wait for the opportunities to be offered by the People's Bank of China. In the case of Banque Indosuez, Guangzhou Branch, and other French banks' branches in China, they tried to forge close relationships with the People's Bank of China Head Office and regional branches, and regional governments, so they could gain wider business scope and sources. For instance, regularly calling on and reporting to the People's Bank of China regional branches is one of the most important tasks for the senior manager of these branches. They also pay attention to maintaining friendly relations with regional government agents. As a result of these efforts, many branches of French banks gained more opportunities to be involved in the Chinese economic development. As mentioned earlier, French banks are among the several most active foreign banks for lead-managing and co-lead-managing syndicated credits in China.

In answering question ten in Questionnaire 2 (see App. B, Questionnaire 2: Q10), several respondents from the branches of French banks considered that establishing joint ventures with a selection of domestic financial institutions is one way of winning support from the government.

Of course, establishing a joint venture or cooperative financial institution may not be the most effective way to develop foreign banks' business activities in China because the

foreign banks could not fully control management. However, the business scope of a joint venture bank is wider than that of a wholly foreign-owned one. This is because it has more privileges and can receive better treatment from the regional government authorities and agents. Also, the foreigners can more easily become close to their local customers and the Chinese financial market through their Chinese partners. In short, because the business scope of foreign banks is limited, to expand their business activities in China, foreign banks may seek through different ownership arrangements to expand their business. Of course, the wholly foreign-owned branches should play the leading role and the joint venturers the supplementary role.

Yet the ANZ Shanghai Branch had a very different perception of establishing a joint venture operation in China. They stated that “banking is a high risk business, and we would want 100 % control.”

From the above, it would appear that the French banks employed active and aggressive business strategies to develop their business activities in China, not just passively following their domestic customers to China to provide them with various financial services. However, the business strategies of Australian banks are more conservative than those of the French banks.

7. CONCLUSION AND RECOMMENDATIONS

7.1 Conclusion

7.1.1 Summary of Findings

In the past hundred years, many top banks in the world have gained great benefits from their international expansion. Because there is a limit to expansion within the domestic markets, international banking provides the scope for both growth and high profitability.

Since the late 1960s, many internationally active banks have had successes in the developing countries. These successes were credited to their competitive advantages in providing a wider variety of banking products; and high quality services to clients in their host countries' banking markets. However, the foreign banks in developing countries (in most of their host foreign countries) have had some limitations imposed on them by the host countries' government regulations. Foreign banks are also often hurt by restrictions on business activities, lack of sophisticated financial systems, changing policies and so on. Recently, most foreign banks are facing new challenges in the developing countries due to the change of the regional or their host countries' financial market environments.

As in some developing and newly industrialised countries under restrictive regulatory structures, foreign bank branches have achieved satisfactory performance in the Chinese financial market. Most foreign banks complained that the scope allowed them is too limited and that it is too difficult to do business in China. Some foreign banks and foreign financial observers criticised the pace of the opening of the Chinese financial market, especially the opening of domestic banking business to foreigners which is still slow, and have criticised the fact that the current reforms do not provide more opportunities for their business activities. However, this research has indicated that the second stage of the Chinese economic and financial reforms should bring opportunities to foreign banks

which should outweigh their challenges or difficulties. Foreign banks still face the difficulty that they do not have access to domestic banking, but in other respects they are the beneficiaries of China's program of economic reform. This is because most of the measures in the second stage of the Chinese financial reform were designed to promote the opening up of the Chinese financial market.

The research also indicated that potential business opportunities have appeared in China's financial market and foreign financial institutions are facing some new challenges under the new circumstances. It is necessary for foreign financial institutions to design adequate strategies and sound operating policies to seize those business opportunities and to face new challenges in order to expand their business activities in China.

The research further shows that the number of foreign financial operational branches and subsidiaries have doubled and redoubled since late 1993. After being in China for more than a decade, many foreign banks have settled into a strong presence in China, mainly through branches, operating subsidiaries and representative offices in coastal cities and Special Economic Zones. Under strained operating circumstances, many foreign bank branches are performing well in the Chinese financial market with their excellent business skills, high quality services and aggressive market strategies. Many foreign banks such as those of the United States, Japan, Hong Kong, UK, France, Germany and other countries use their remarkable ability to compete against other foreign counterparts in expanding their market share in China. Those foreign bank branches have had success in promoting their products and services to both local and foreign customers, and are actively participating in China's key construction projects.

However, unlike other Australian industries which are strengthening their operations or cooperative undertakings in China, in respect of their number of operating institutions in the Chinese financial market Australian banks are behind the French banks. The research indicated that Australian banks were in an unfavourable position as compared with

French banks, and the business strategies of Australian banks are more conservative than those of the French banks.

7.1.2 Prospects and Outlook for Australian Financial Institutions in China

The Australian financial industry has a promising future and a great opportunity to expand their business activities in China. As for other Australian industries, China is a very large potential market to explore and invest in.

Although Australian banks are unlike their competitors, such as American and French banks which have formed comprehensive operating networks and are actively performing in China, Australian banks have many competitive advantages over the competitors mentioned above. These include things such as geographical position and multicultural background. In particular the Sino-Australian relationship has been well maintained since Australia establish diplomatic relations with China in the earlier 1970s, and Sino-Australian trading, economic cooperation and Australian direct investment have increased rapidly in recent years. All of which can assist Australian banks against other competitors in China's financial market.

The Australian financial institutions certainly face a lot of challenges and difficulties in expanding their business activities in China. However, ANZ Shanghai Branch, several Australian insurance companies (such as National Mutual, Colonial Mutual) and other financial institutions have built up a good reputation in China with their more than hundred years business experience and superior financial technology.

I believe that the Australian financial institutions will be successful in promoting their products and services in China's market, and will catch up with other counterparts such as French, UK and German banks in the competitive Chinese financial market in the

future years provided that Australian banks employ active and aggressive business strategies.

7.2 Recommendations

7.2.1 Recommendations to Foreign Financial Institutions

The following action points are recommended for foreign financial institutions in China.

- Understand the Chinese government’s policies and the political and economic environment of the country.
- Adopt adequate business strategies and policies in order to fit the new circumstances.
- Build up connections with domestic clients (such as state-owned enterprises or enterprises in other ownerships) in order to be prepared for the opening up of renminbi operations.
- Use an aggressive market strategy - to provide high quality services and products to private sector and non-state-owned enterprises so as to establish new customer networks and enlarge foreign bank branches’ market occupancy in China.
- Seek a chance to enter into China’s real estate industry and real estate lending area, select a Chinese partner to cooperate in promoting home loan products and services to the locals.
- Liaise with the regional branches of the People’s Bank of China and government agents in order to gain more opportunities for participating in China’s core economic construction projects.

- Design adequate strategies and sound policies to seize new business opportunities in China's insurance industry.
- Further reinforce branches' strength, and improve service quality in order to secure advantages against other competitors in the adverse environment of intensified market competition.
- Make adequate provisions for credit risk management and risk exposure.
- The top ranks of managers who came from the home countries should pay attention to understanding the Chinese culture in order to localise their management.

7.2.2 Recommendations to Australian Financial Institutions

- Examine and adjust the current business strategies which were adopted in China's financial market, as well as adopt a focused approach in order to improve Australian financial institutions' positions in China.
- Pay attention to maintaining a close relationship and contact with the People's Bank of China and government agents.
- Create strong links with the local Chinese enterprises, as well as the local Chinese financial institutions.
- Provide services and products in various forms to overcome difficulties of business limitation and insufficient operating network in order to increase economic returns.
- Develop non-banking business activities.

- Increase the number of operating branches and subsidiaries in order to form a truly comprehensive network in China.
- Establish joint venture operating subsidiaries in partnership with the local Chinese financial institutions in order to more easily become close to the Chinese government authorities, local customers and the local financial market place.

7.3 Suggestions for Further Research

Further research should be more narrowly focussed, with the research method being either those of descriptive research or correlational research.

Further research on the opportunity for foreign financial institutions to participate in China's core economic construction projects should be carried out.

Further research should also be carried out on the development of the Chinese real estate industry and home loan business.

Further research is required on the implications of the opening of China's insurance market to foreign insurance companies.

Further research is needed on credit risk management in the Chinese financial market.

The above further research seems to be important and useful for foreign financial institutions to understand China's current financial market environment. In addition, if the money and time are available, such research would gain more valuable results if undertaken in China.

8. APPENDICES

8.1 APPENDIX

8.1.1 List of References

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8.2 APPENDIX B

8.2.1 Questionnaire 1

VICTORIA UNIVERSITY OF TECHNOLOGY
Faculty of Business
MBA program

QUESTIONNAIRE FOR FINANCIAL INSTITUTIONS RESEARCH

The purpose of this study is to provide information to help foreign financial institutions understand the major problems and barriers in developing the business activities in Chinese market for foreign financial institutions. It would be appreciated if you would spare a few moments to complete the questionnaire.

* Name of institution (optional) _____

* If there is insufficient space provided for your answers, please continue them on blank papers attached to the questionnaire.

=====

Q1. Is your organisation a bank or non-bank financial institution?

Bank ()

non-bank ()

Q2. In which city is your organisation located ?

Q3.

a. Do you believe the current Chinese economic and financial reforms is increasing opportunities for foreign financial institutions to expand their business activities in China?

Yes () No ()

b. If yes, please provide a more detailed response to the above question.

Q4.

a. In March 1993, the first Chinese banking act -- the People's Bank of China Act has been passed by the National People's Congress in Beijing and has been enforced in the same time. Do you believe it is favourable for a fair competition between both foreign and local financial institutions?

Yes () No ()

b. If yes, please provide a more detailed response to the above question.

c. If no , what further information would you like to supply?

Q5.

a. Do you believe the People's Bank of China Act will create a good financial market order, and will help foreign financial institutions to deal business easily in China ?

Yes () No ()

b. If yes, please provide a more detailed response to the above question.

Q6. What do you believe are the competitive advantages of the foreign banks in their business activities in China over that of the Chinese commercial banks?

Q7. What do you believe are the competitive disadvantages of the foreign banks in their business activities in China over that of the Chinese commercial banks?

Q8.

a. The People’s Bank of China has made a decision to select two cities (Shanghai and Guangzhou) as the places where an experiment is made, for foreign banks to engage in renminbi business. Several foreign banks will be selected by the People’s Bank of China to be involved in this operation. Do you think every foreign bank must try in every possible way to get this opportunity?

Yes () No ()

b. If yes, please provide a more detailed response to the above question.

c. If no, what (further) information would you like to supply?

Q9.

a. With the transformation of the state-owned specialised banks into the state-owned commercial banks, the existing saving structure would be broken down, and capital must become the focus of competition for each Chinese commercial bank. On the other hand, a set of reforms such as social security reform, education system reform, and housing system reform would lead to the residents putting in large amounts of money into insurance. Do you believe the challenge of saving for Chinese banks would offer more opportunities to foreign banks to develop their loaning operation ?

Yes () No ()

b. If yes, please provide a more detailed response to the above question.

Q10.

a. Since 1995, the Chinese government has pushed the pace of the social security system reforms, through establishment and perfection of the new unemployment insurance, medical insurance, and pension insurance systems in order to meet the needs of the state-owned enterprises reform. Do you believe the foreign insurance companies must seize this rare chance to enter into China ?

Yes () No ()

b. If yes, please provide a more detailed response to the above question.

Q11.

a. Foreign banks had few opportunities to carve out niches in the investment program in the Chinese economy, and their loans activity is relatively at a low level. Do you think the establishment of three Chinese policy banks and the transformation of state-owned banks into stated-owned commercial banks would further increase the difficulties in the above aspects?

Yes () No ()

b. If yes, please provide a more detailed response to the above question.

c. If no, please explain the reasons.

Q12.

a. Although the People's Bank of China has decided to relax restrictions on foreign bank business ; scope, operation and location. Do you think the business scope is still limited by regulation in order to protect the benefits of local banks?

Yes () No ()

b. If yes, please provide a more detailed response to the above question.

Q13

a. Do you believe the current and future Chinese economic and financial reforms would bring about new challenges to foreign banks?

Yes () No ()

b. If yes, please provide a more detailed response to the above question.

c. If no, please explain the reasons.

Q14.

Are there any other comments which you would like care to make on this topic?

Thank you for your cooperation. On completion, please mail this survey to:

Hong Jin Wang

Master of Business Administration

Victoria University of Technology

City Campus

PO Box 14428

MMC Melbourne

VIC 3000

Australia

OR Send it back in the enclosed envelope.

8.2.2 Questionnaire 2

VICTORIA UNIVERSITY OF TECHNOLOGY
Faculty of Business
MBA program

QUESTIONNAIRE FOR FINANCIAL INSTITUTIONS RESEARCH

The purpose of this study is to provide information to help foreign financial institutions understand the major problems and barriers in developing the business activities in the Chinese financial market under the circumstances of the current and future economic and financial reforms. It would be appreciated if you would spare a few moments to complete the questionnaire.

* Name of institution (optional) _____

* If there is insufficient space provided for your answers, please continue them on the blank pages attached to the questionnaire.

=====

Q1. Is your organisation a bank or non-bank financial institution?

- Bank ()
- Non- bank
- Insurance company ()
- Leasing company ()
- Others ()

Q2. Is your organisation a joint Chinese - Foreign financial institution?

Yes () No ()

Q3. In which city is your institution located?

Q4. When did your institution enter into China and begin operating in this city?

Q5. How did you design the form and the size of your operation in China?

Q6. Which of the benefits below do you think would be the most important reasons for your institution's presence in China?

- ◆establish branches to expand your institution's business in to the Chinese market ()
- ◆support your clients who invest in China ()
- ◆provide intelligence for your worldwide operation ()

Q7. Which of the following business operations have been engaged in by your institution?

- ◆Granting loans in local and foreign currencies and discounting bills ()
- ◆Inward remittances from foreign countries, and collection of foreign exchange ()
- ◆Settlement of export transactions and outward documentary bills ()
- ◆Exchange in foreign currencies and foreign currency bills ()
- ◆Renminbi and foreign currency investments ()
- ◆Renminbi and foreign currency guarantees ()
- ◆Buying and selling of stocks and securities ()
- ◆Trust, safe deposit box, credit investigation and consulting services ()
- ◆Outward remittances by overseas Chinese enterprises, foreign enterprises Chinese-foreign joint ventures and Chinese-foreign cooperative enterprises, settlement of import transactions and inward documentary bills ()

- ◆Local and foreign currency deposits and overdrafts by foreign enterprises, Chinese-foreign joint venture enterprises and so no, and by foreign nationals etc ()
- ◆Handling foreign exchange deposits and loans in foreign countries and the Hong Kong and Macao regions ()
- ◆Other business operations (please provide more detailed information) ()

Q8.

a. In the late 1980s, the Shanghai government decided that the city should regain it status as China’s main financial center, a position it had held in the 1930s. More recently, many foreign banks have entered that city one after another. Do you think the foreign financial institutions must focus on Shanghai rather than harmoniously expand into several richest cities and provinces?

Yes () No ()

b. If yes, please explain the reasons.

c. If no, beside Shanghai, which of the following regions do you think would also be focused on?

- The Yangtze River Delta ()
- The Pearl River Delta ()
- The Southern Fujian Delta ()
- The Liaodong Peninsulas ()
- Shandong Peninsula ()
- The Bohai Bay rim area ()

Q9.

a. Usually, Chinese-foreign joint venture and cooperative financial institutions have more privileges and receive better treatment from the relevant Chinese authorities. Do you think the most effective way to develop your organisation’s business activities in China is to establish a joint venture or cooperative financial institution?

Yes () No ()

- b. If yes, please provide a more detailed response to the above question.
- c. If no, please explain the reasons.

Q10. Which of the following strategies do you think would help your institution have success in the Chinese financial market? (Please rank 1 - most important, 2 - next important, and so on)

- ◆to localise your management ()
- ◆to be good at dealing with the Chinese authority and government agents ()
- ◆to be good at taking advantage of the imperfections of the Chinese financial regulations and system ()
- ◆to be politically sharp and better understand the policies ()
- ◆to provide efficiency and high quality services to customers ()
- ◆to be flexible and often adjust your strategies to fit the political and economic climate ()
- ◆to build up cooperative relationships with local financial institutions ()
- ◆to have location advantages ()
- ◆to put trust in local staff and pay attention to improving their skills ()

Q11.

a. Is your branch implementing a strategy to become involved in Chinese key construction projects, by joining with the Chinese financial institutions to organise banking consortium loans to those big projects?

Yes () No ()

b. If yes, please provide a more detailed response to the above question.

Q12.

a. Have you any current marketing strategies or plans, relative to following the current and future Chinese economic and financial reforms ?

yes () No ()

b. If no, please explain.

c. If yes, what are they?

Q13. If you would like to make any other comments on how to reduce barriers to expansion of business activities in China and how to adjust market strategies in order to fit the new political and economic climate, they would be most gratefully received.

Thank you for your cooperation. On completion, please mail this survey to:

Hong Jin Wang
Master of Business Administration
Victoria University of Technology
City Campus
PO Box 14428
MMC Melbourne
Victoria 3000

OR Send it back in the enclosed envelope

8.3 APPENDIX C

1. List of Chinese Banks and Foreign Banks Sent Questionnaire 1

(1) Chinese banks

■ Beijing

- The People’s Construction Bank of China (headquarters)
- China Investment Bank (headquarters)
- The People’s Insurance Company(headquarters)

■ Shanghai

- The People’s Bank of China, Shanghai Branch

■ Guangzhou

- The People’s Bank of China, Guangdong Branch
- The Bank of China, Guangdong Branch
- The Industrial and Commercial Bank of China, Guangdong Branch
- The Agricultural Bank of China, Guangdong Branch
- The People’s Construction Bank of China, Guangdong branch

(2) Foreign banks

■ Beijing

- ANZ Bank, Beijing Representative Office
- Westpac Banking Corporation, Beijing Representative Office

■ Shanghai

- ANZ Bank, Shanghai Branch
- Crédit Lyonnaise, Shanghai Branch(France)

■ Guangzhou

- The Bank of Montreal, Guangzhou Branch (Canada)
- The Bank of Nova Scotia, Guangzhou Branch (Canada)
- Hong Kong Nan Yang Commercial Bank, Guangzhou Branch (Hong Kong)
- Banque Nationale de Paris, Guangzhou Branch (France)
- Banque Indosuez, Guangzhou Branch (France)
- Société Générale, Guangzhou Branch (France)
- The Sakura Bank, Ltd, Guangzhou Branch (Japan)

2. List of Chinese Banks and Foreign Banks Sent Questionnaire 2

(1) Chinese banks

■ Guangzhou

- The People’s Bank of China, Guangdong Branch

■ Shanghai

- The People’s Bank of China, Shanghai Branch

(2) Foreign banks

■ Guangzhou

- Banque Nationale de Paris, Guangzhou Branch
- Société Générale, Guangzhou Branch
- Banque Indosuez, Guangzhou Branch

■ Shanghai

- ANZ Bank, Shanghai Branch
- Crédit Lyonnais, Shanghai Branch
- Banque Indosuez, Shanghai Branch

■ Shenzhen

- Banque Nationale de Paris, Shenzhen Branch
- Société Générale, Shenzhen Branch
- Banque Indosuez, Shenzhen Branch

3. List of Interviewees

Name	Titles and Employing Organisation	Place
Audrey Chong	General Manager Asia Pacific Region Colonial Mutual Group	Melbourne
Bernard Bareges	General Manager Banque Nationale de Paris, Guangzhou Branch	Cuangzhou
Chen YaoCheng	Chief of Capital Construction Management Department, the People’s Construction Bank of China Guangdong Branch	Guangzhou
Feng Ying	Economist the People’s Bank of China Shenzhen Branch	Shenzhen
Li Fu	Director of Investment Research Institute the People’s Construction Bank of China Guangzhou Branch	Guangzhou
Ling Weilie	Assistant General Manager Credit Department of China Investment Bank Guangdong Branch	Guangzhou

Li Neng	Assistant Manager the People's Insurance Company of China Guangdong Branch	Guangzhou
Liu Wei	Economist The People's Bank of China Shenzhen Branch	Shenzhen
Luo Zhong	Senior Officer the Bank of East Asia, Guangzhou Branch	Guangzhou
Lu JingXiong	Senior Economist the People's Construction Bank of China Guangdong Branch	Guangzhou
Jack D. Xie	Manager of Trade Finance the Bank of Nova Scotia Guangzhou Branch	Guangzhou
Philippe Bo	Assistant Manager of Operations & administration Banque Nationale de Paris, Guangzhou Branch	Guangzhou
Ronald Jim	Deputy General Manager Banque National de Paris Guangzhou Branch	Guangzhou
Shi XiaBing	President the People's Construction Bank of China Shenzhen Branch	Shenzhen
Sophie Zhong	Project Finance Manager Banque Indosuez Guangzhou Branch	Guangzhou

Tan JianSheng	General Manager of the International Division the People’s Construction Bank of China Guangdong Branch	Guangzhou
Vincent Wu	Manager Hong Kong Nan Yang Commercial Bank Guangzhou Branch	Guangzhou
Xia Zhong	Representative Swiss Bank Guangzhou Representative Office	Guangzhou
Yang Jie	Manager the People’s Bank of China Guangdong Branch	Guangzhou
Ye Jing Tai	Deputy President the People’s Construction Bank of China Guangdong Branch	Guangzhou
Zhang JinXiang	Chief of Investment Department the People’s Construction Bank of China Guangdong Branch	Guangzhou
Zhan SongMao	Manager China Merchants Bank Guangzhou Branch	Guangzhou
Zhou Jun	Senior Economist China Investment Bank	Guangzhou

Zhou Yi

Senior Economist

the Industrial & Commercial Bank of China

Guangdong Branch

Guangzhou

8.4 APPENDIX D

Summary of the Commercial Banking Law of the PRC and Regulations Governing Foreign Banks and Joint Chinese - Foreign Banks

1. General Provisions of the Commercial Banking Law of the People's Republic of China

Article 1: This law is formulated to protect the legitimate rights and interests of commercial banks, depositors and other clients, standardise the behaviour of commercial banks, improve the quality of funds, strengthen supervision and administration, ensure safety and soundness of commercial banking, maintain a normal financial order and promote the development of the socialist market economy.

Article 2: The commercial banks referred to in this law are bodies corporate established in accordance with this law and the Company Law of the People's Republic of China to receive money deposits from the public, extend loans, provide settlement services and do other relevant business.

Article 3: A commercial bank may engage in some or all of the following businesses:

1. receiving money deposits from the public;
2. extending short, medium and long - term loans;
3. providing domestic and international settlement services;
4. discounting bills;
5. issuing financial bonds;
6. acting as agent for issuing, cashing and underwriting government bonds;
7. dealing in government bonds;
8. inter-bank call-money business;

9. dealing or acting as agent in foreign exchange transactions;
10. providing L/C service and guarantee;
11. acting as agent in collection and payment and insurance business;
12. providing safe deposit box service;
13. other business approved by the People's Bank of China.

The business scope of a commercial bank is defined by the statute thereof and reported to the People's Bank of China for approval.

Article 4: A commercial bank operating independently, takes up responsibility for all risks it may encounter and for its own profits and losses it may bear, and exercises self-regulating mechanisms on the management principle of economic efficiency, safety and liquidity.

A commercial bank shall conduct its business in accordance with the law, free from interference by any department or individual.

A commercial bank shall assume civil responsibilities independently with its entire assets as a body corporate.

Article 5: A commercial bank shall abide by the principle of equality, voluntariness, fairness, honesty and good faith in doing business with its clients.

Article 6: A commercial bank shall protect its depositors' legitimate rights and interests from encroachment by any organisation or individual.

Article 7: In doing credit business, a commercial bank shall strictly examine the credibility of a borrower and persist in extending loans against collateral in order to ensure recalling loans on time.

A commercial bank is protected by law to retrieve the principal and interests of a loan from the borrower thereof in accordance with the law.

Article 8: A commercial bank shall abide by the relevant provisions of the law and administrative decrees and regulations in doing business and shall not impair the interests of the state or the public.

Article 9: A commercial bank shall abide by the principle of fair competition in doing business and refrain from unfair competition.

Article 10: A commercial bank shall be subject to supervision and administration by the People's Bank of China in pursuance of the law.

If laws and administrative decrees have special stipulations regarding banks of foreign capital, Chinese-foreign joint banks and branches of banks of foreign countries under jurisdiction of the provisions of this law, those special stipulations shall apply.

2. Summary of the Regulations Governing foreign banks and Joint Chinese - Foreign Banks in Special economic Zones of the PRC (Promulgated by the State Council on April 2, 1985)

1). Foreign and joint Chinese foreign banks shall abide by the laws and regulations of the People's Republic of China; their legitimate business operations and legal rights shall be protected by the People's Republic of China.

2). Based on an application submitted, the People's Bank of China may grant its approval to foreign and joint Chinese foreign banks to engage in some or all of the following business operations;

- Granting loans in local and foreign currencies and discounting bills;
- Inward remittances from foreign countries and Hong Kong and Macao regions, and collection of foreign exchange;

- Settlement of export transactions and outward documentary bills;
- Exchange in foreign currencies and foreign currency bills;
- Renminbi and foreign currency investments;
- Renminbi and foreign currency guarantees;
- Buying and selling of stocks and securities;
- Trust, safe deposit box, credit investigation and consulting services;
- Outward remittances by overseas Chinese enterprises; foreign enterprises, Chinese-foreign joint ventures and Chinese-foreign cooperative enterprises, settlement of import transactions and inward documentary bills;
- Local and foreign currency deposits and overdrafts by overseas Chinese enterprises, foreign enterprises, Chinese-foreign joint ventures and Chinese-foreign cooperative enterprise, and by foreign nationals, overseas Chinese and Chinese compatriots in Hong Kong and Macao;
- Handling foreign exchange deposits and loans in foreign countries and the Hong Kong and Macao regions; and
- Other business operations.

3). The loans granted by a bank's head office or a joint Chinese - foreign bank in a special economic zone to any enterprise in the same zone shall not exceed 30% of the aggregate of the banks paid -- in capital and reserve funds; and its total investment in the special economic zone shall not exceed 30% of the aggregate of its paid -- in capital and reserve funds.

4). The interest rates applied by a foreign or joint Chinese - foreign bank to local or foreign currency deposits, loans, overdrafts and bill discounts within a special economic zone shall be fixed by reference to those prescribed by the branch of the People's Bank of China in the same zone.

8.5 APPENDIX E

The Agricultural Bank of China (ABC). This bank was established in March 1955 but closed after 21 months and merged with PBOC. It reopened again in November 1963 and operated independently for 22 months, and then it was again merged with PBOC. With respect to the existing domestic financial institutions, the Agricultural Bank of China (ABC) was reactivated in 1979 to focus exclusively on the funding needs of the agricultural sector.

Bank of China (BOC). This bank was established in 1912, and specialised in international banking activities under the Kuomintang government. In May 1949, when Shanghai was taken over by the Chinese Communist Party, the People's Government took over the bank, confiscated its assets, and restructured the management team. In October 1949, the head office was moved from Shanghai to Beijing, and in late 1953, the Chinese Government Administrative Council designated BOC as a Specialised bank to deal with foreign exchange under the leadership of PBOC

The Industrial and Commercial Bank of China (ICBC) was created in 1983 to take over the PBOC's credit operations. The largest and most influential of the specialised bank and the largest commercial bank in China.

Bank of Communications (BOCOM) was established on March 4, 1908, and played an active role in financing projects in transportation, telecommunications, and postal service as well as in industry and commerce. After 1949, the bank was taken over by the People's Government and reformed with respect to ownership, operation and management. The bank was placed under the Ministry of Finance to supervise the affairs of joint state-private enterprises. In 1951, the head office was moved from Shanghai to Beijing and in

1958, the bank's domestic operations were consolidated with those of PBOC. It was restabilised in 1987.

The People's Construction Bank of China (PCBC) was founded in October 1954, by the government Administrative Council within the Ministry of Finance to handle budget appropriations for capital construction.

China Investment Bank (CIB) China regained its legal position in the World Bank in 1980 and subsequently decided to establish a financial institution to manage World Bank loans, Asian Development Bank loans, and loans from other international lending agencies that were expected for industrial projects in China. On December 1981, with approval of the State Council, China Investment Bank (CIB) was officially established as the financial intermediary that would perform this task. CIB is supervised by PCBC.

CITIC Industrial Bank (CITICIB) emerged from the former Banking Department of China International Trust and Investment Corporation (CITIC) which is a ministerial corporation under the State Council. The Banking Department was set up in December 1985, and it was established as the CITIC Industrial Bank (CITICIB) in May 1987, with the approval of the central bank and the State Council.

Source: The People's Bank of China