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Discussion on the Influence of Overseas Financial Institutions' Participation in Shares on the Operation Efficiency of China's Banking Industry

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ABSTRACT

With the implementation of China's reform and opening up policy and China's successful accession to the World Trade Organization, more and more overseas financial institutions are participating in various Chinese banks, and the amount of investment is also expanding. Therefore, it is particularly important to study the impact of overseas financial institutions participating in the Chinese Banks on the operating efficiency of the China's banking industry. Therefore, based on the previous literature research, this paper constructs six models to explore whether foreign financial institutions participate in shares and the impact of shareholding ratio on the operating efficiency of China's banking industry.

1. Introduction

With the implementation of China's reform and opening up policy and China's successful accession to the World Trade Organization in 2001, more and more overseas financial institutions have begun to participate in the development of China's banking industry, the most important of which is to participate in major banks. Since the establishment of the representative office of the Japanese Export and Export Bank in Beijing in 1979, more and more overseas financial institutions have been approved to establish operating branches in China. The business branches of overseas financial institutions generally operate some liaison with other institutions, promote the products of financial institutions, conduct research on financial markets for strategic decision-making, and communicate technically with other institutions, which does not directly carry out business-related activities of overseas fi-

ancial institutions. In addition to operating branches, many overseas financial institutions have established representative offices in China. The main task of the representative office is to make strategic decisions and other strategic related content for overseas financial institutions. Later, with the changes in China's policies and changes in the international situation, the number of overseas financial institutions established in China has increased several years. The specific growth situation is shown in Figure 1.

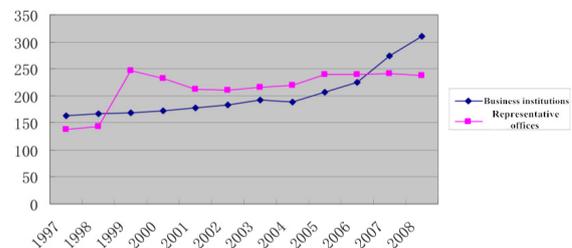


Figure 1. The number of overseas financial institutions

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In this context, the business between overseas financial institutions and major Chinese banks is becoming more and more convenient and more frequent. At the end of 1996, China's first example of overseas financial institutions participating in the Chinese Banks appeared. When China Everbright Bank was not listed, the Asian Development Bank exchanged 320 million yuan for 3.29% of China Everbright Bank. However, in the following four years, only the International Finance Corporation purchased 7% and 5% of the shares of Everbright Bank and Shanghai Bank respectively.^[1] In addition, there are no other foreign financial institutions involved in the purchase of shares in various Chinese banks. After China joined the World Trade Organization and China-related laws emerged, more overseas financial institutions participated in the purchase of shares in various Chinese banks. Some overseas financial institutions participated in the Chinese Banks as shown in Table 1:

Table 1. The situation of overseas financial institutions' participation in shares

Date	Overseas financial institutions	Participation objects	participation in shares %
1996	Asian Development Bank	Everbright Bank	3.00
1999.09	International Finance Corporation	Shanghai Bank	5.00
2001.11	International Finance Corporation	Nanjing Commercial Bank	5.00
2001.12	Youlian Shipyard Co., Ltd.	China Merchants Bank	4.33
2003.09	Citibank	Pufa and his party	5.00
2003.09	International Finance Corporation	Minsheng Bank	1.22
2004.03	Hang Seng Bank	Industrial Bank	18.98
2004.06	International Finance Corporation	Xi'an Commercial Bank	2.50
2004.08	HSBC	Bank of Communications	19.90
2004.09	American Newbridge Investment Group	Shenzhen Development Bank	19.89
2004.11	Commonwealth Bank of Australia	Jinan City Commercial Bank	11.00
2005.03	Dutch Bank Group	Bank of Beijing	19.90
2005.04	Commonwealth Bank of Australia	Hangzhou Commercial Bank	19.90
2005.06	Bank of america	Construction bank	9.00
2005.08	Royal Bank of Scotland	Bank of China	10.00
2005.10	Deutsche Bank	HSBC Bank	14.00
2005.12	Standard Chartered Bank	Bohai Bank	19.99
2006.05	OCBC Bank	Bank of Ningbo	12.20
2006.11	BBBC	CITIC Bank	4.83
2006	Goldman Sachs Investment Group	ICBC	10.00

It can be seen from the table that after 2001, the number and amount of overseas financial institutions participating in the Chinese Banks have increased significantly, although the proportion of shares held by the Chinese Banks is not very high, however, it has a relatively strong and far-reaching impact on the development of the Chinese Banks. Therefore, it is very important to study the impact of overseas financial institutions on the participation of Chinese banks, especially the impact on the operating efficiency of China's banking industry.

2. Four Investment Modes of Chinese-Funded Banks

Although many domestic banks in China are attracting foreign investment, different banks have different needs for the introduction of funds. Therefore, Chinese-funded banks have different modes for introducing funds, which are divided into the following four categories^[2]:

2.1 Stock Reorganization Mode

The implicit institutional demand for this type of investment mode requires China to require several large commercial banks that are consistent with world standards. China's Construction Bank, Chinese Banks and Bank of Communications all adopt this mode of attracting investment. When different banks adopt this same mode of attracting investment, they have certain in common. When the funds of overseas financial institutions enter the Chinese Banks, they must be accompanied by certain institutional changes or changes in management strategies, therefore, this kind of investment method is accompanied by the system content.

2.2 Incremental Expansion Mode

The incremental expansion mode refers to the mode of introducing foreign capital when the stock is constant or the amount of change is relatively small. This kind of investment mode has three characteristics. First, in the two extreme areas of the China's banking industry, it is more inclined to choose this kind of investment mode; second, the cooperation objects of this kind of investment mode generally have relatively high technicality. The areas of general cooperation are in the bank's credit card-related business, bank retail business (insurance, etc.), bank risk management, financial control, training in banking practitioners, and other areas; third, the bank's profitability using this mode is generally better, so they pay more attention to the long-term development of the bank.

2.3 Risk Resolution Mode

This kind of investment mode refers to the mode of introducing foreign capital to commercial banks that are in a liquidity predicament or facing other crises and seeking help from overseas financial institutions. This investment mode has three characteristics: first, Chinese banks that participate in this mode of attracting investment are generally small and medium-sized banks that are in financial difficulties; second, overseas financial institutions participating in this mode of attracting foreign investment generally have a relatively strong ability to resolve the crisis; third, the speculative nature of this mode of attracting investment is more prominent^[3].

2.4 Investment Transfer Mode

This type of investment is not as specific as the former, but a relatively simple property transaction. The characteristics of this investment mode are: (1) Chinese banks involved in this mode of introduction require a certain amount of capital, and foreign financial institutions need to set up branches in China to test China's financial market; (2) The main form of such investment mode is shareholder transactions; (3) Although foreign investors participate in Chinese banks, they are less involved in the operation and management of Chinese banks.

3. Ways in Which Overseas Financial Institutions Participate In Shares Affects the Efficiency of Bank Operations

This paper studies the impact of the participation of overseas financial institutions on the economic efficiency of China's banking industry, rather than the impact of a specific case. Therefore, it lists the ways in which the above four methods of investment affect the efficiency of bank operations.

(1) The most direct and fastest impact of overseas financial institutions' participation in the Chinese Banks is the capital of the Chinese Banks. Adequate capital can guarantee the expansion of the size of the Chinese Banks. Previous literature has proved that the expansion of the scale of banks can form economies of scale and scope, bringing operating efficiency to the bank.

(2) For some banks that adopt the first two types of investment models, in addition to the introduction of capital, the internal management methods, operation methods and management methods of the board of directors will change. With the help of overseas financial institutions, the Chinese banks adjusted their management methods and re-appointed members of the board of directors to

fundamentally improve their management systems and improve the bank's operating efficiency.

(3) The participation of overseas financial institutions can effectively implement a more comprehensive risk management system for Chinese banks, so that Chinese banks can establish a comprehensive and responsive risk management system and improve the ability of Chinese banks to cope with risks, thereby improving the operating efficiency of Chinese banks.

(4) The financial products of overseas financial institutions are relatively rich. Therefore, after the participation of overseas financial institutions, they can make positive revisions to various financial products of the Chinese Banks. After listening to the opinions, the Chinese Banks can appropriately modify its products and services to increase the competitiveness of its products, thereby improving the operating efficiency of Chinese banks^[4].

(5) Change the sales method and operation mode of the Chinese bank and modify and improve its business process. Overseas financial institutions that can participate in various Chinese banks must have relatively complete and advanced management, sales and business models. After the shareholding, overseas financial institutions can share the more advanced model ideas with Chinese banks, making Chinese banks more competitive in China's financial market.

4. Empirical Study on the Impact of Overseas Financial Institutions' Participation on the Operating Efficiency of China's Banking Industry

The impact of the participation of overseas financial institutions on the operating efficiency of Chinese banks often needs to be observed for a period of time before they can be observed. And from Table 1, we can see that most of the overseas financial institutions' shareholdings are concentrated after 2001, so this paper uses the data of some of the banks in the table for empirical analysis. The data used in this paper includes GDP growth rate, inflation rate, deposit and loan spreads, and so on. The data used in this paper mainly comes from the website of the Bureau of Statistics, the Bankscope database, the annual reports of various banks, and the China Finance Statistics Yearbook.

4.1 Variable Definitions

After the author's research on relevant literature at home and abroad, the previous scholars used the measurement indicators of bank operation efficiency, namely the pre-tax asset profit rate, net interest margin and asset expense rate. In order to eliminate the influence of external factors on the bank's operating efficiency, this paper also

selected two sets of control variables, the first group is GDP growth rate and inflation rate; The second group is the logarithm of the bank's total assets (inasset), bank loan-to-deposit ratio (ldr), bank asset cost ratio (cost), and bank net interest margin (nim).

4.2 Building Models

Based on the above content and the analysis of relevant literature, this paper proposes the following six models to test the impact of overseas financial institutions' shareholding on the operating efficiency of China's banking industry. The model is divided into two categories. The first category is the impact of whether overseas financial institutions participate in the bank's operating efficiency. The three models proposed in this paper are shown in Figure 2:

$$\begin{aligned}
 \text{profit}_i &= \alpha_i + \beta_1 \text{fis} + \beta_2 \ln \text{asset} + \beta_3 \text{cost} + \beta_4 \text{nim} + \beta_5 \text{ldr} + \beta_6 \text{gdp} \\
 &+ \beta_7 \text{inflation} + \beta_8 \text{spread} + \xi_i \\
 \text{cost}_i &= \alpha_i + \beta_1 \text{fis} + \beta_2 \ln \text{asset} + \beta_3 \text{nim} + \beta_4 \text{ldr} + \beta_5 \text{gdp} + \beta_6 \text{inflation} \\
 &+ \beta_7 \text{spread} + \xi_i \\
 \text{nim}_i &= \alpha_i + \beta_1 \text{fis} + \beta_2 \ln \text{asset} + \beta_3 \text{ldr} + \beta_4 \text{gdp} + \beta_5 \text{inflation} \\
 &+ \beta_6 \text{spread} + \xi_i
 \end{aligned}$$

Figure 2. Model 1-3

The second type of model is the impact of the proportion of foreign financial institutions participating in the bank's operating efficiency. The three models proposed in this paper are shown in Figure 3:

$$\begin{aligned}
 \text{profit}_i &= \alpha_i + \beta_1 \text{ratio} + \beta_2 \ln \text{asset} + \beta_3 \text{cost} + \beta_4 \text{nim} + \beta_5 \text{ldr} \\
 &+ \beta_6 \text{gdp} + \beta_7 \text{inflation} + \beta_8 \text{spread} + \xi_i \\
 \text{cost}_i &= \alpha_i + \beta_1 \text{ratio} + \beta_2 \ln \text{asset} + \beta_3 \text{nim} + \beta_4 \text{ldr} + \beta_5 \text{gdp} + \beta_6 \text{inflation} \\
 &+ \beta_7 \text{spread} + \xi_i \\
 \text{nim}_i &= \alpha_i + \beta_1 \text{ratio} + \beta_2 \ln \text{asset} + \beta_3 \text{ldr} + \beta_4 \text{gdp} + \beta_5 \text{inflation} \\
 &+ \beta_6 \text{spread} + \xi_i
 \end{aligned}$$

Figure 3. Model 4-6

4.3 Data Result Analysis

The regression results are shown in Figure 4:

	Model 1 profit	Model 2 cost	Model 3 nim	Model 4 profit	Model 5 cost	Model 6 nim
fis	0.001 0.084	0.065 0.018	(0.001) 0.173			
ratio				0.000 0.077	0.011 0.008	0.000 0.051
cost	(0.001) 0.210			(0.002) 0.067		
nim	0.445 0.000	5.825 0.039		0.445 0.000	6.444 0.048	
ldr	(0.007) 0.000	(0.128) 0.329	0.010 0.000	(0.005) 0.049	(0.032) 0.834	0.009 0.000
gdp	0.177 0.000	(5.295) 0.127	0.492 0.000	0.155 0.000	(6.718) 0.114	0.415 0.000
inflation	0.009 0.038	1.725 0.000	(0.015) 0.012	0.012 0.001	2.062 0.000	0.001 0.834
spread	(0.256) 0.000	13.013 0.001	(0.720) 0.000	(0.224) 0.000	19.769 0.001	(0.470) 0.000
lnasset	0.001 0.176	(0.044) 0.615	(0.005) 0.000	(0.000) 0.627	0.037 0.690	(0.005) 0.000
R2	0.916	0.827	0.889	0.912	0.821	0.934
Adjusted R2	0.890	0.777	0.859	0.885	0.770	0.916
F-value	35.655	16.552	29.377	33.814	15.907	51.683
prob (F- statistic)	0.000	0.000	0.000	0.000	0.000	0.000
D.W. -value	1.918	1.492	1.749	1.994	1.627	1.755
Observation No.	108.000	108.000	108.000	108.000	108.000	108.000

Figure 4. regression analysis results

(1) The results of this data container are ideal, and the D.W. value is also ideal, indicating that the model made in this paper is highly convincing.

(2) The return results of the shareholding ratio of overseas financial institutions are more significant. Therefore, the participation rate of overseas financial institutions has a more significant impact on the operating efficiency of China's banking industry.

(3) For the regression results of the two types of models, they are all significant at the 10% level, and the regression coefficient is positive. Therefore, the participation of overseas financial institutions has a positive impact on the operating efficiency of the China's banking industry, that is, it increases the profitability of the China's banking industry. However, the regression coefficient indicates that the positive effect of this shareholding method on the China's banking industry is limited [5].

(4) The effect of net interest margin and deposit-loan spread on pre-tax profit is more significant, but the scale effect of Chinese-funded bank is not significant.

(5) Whether the overseas financial institutions' shareholdings and shareholding ratios are more significant for the return of the asset expense ratio, but the direction of the regression coefficient is opposite. Therefore, when the Chinese-funded bank introduces the management mode, product type and other experience of overseas financial institutions, it will generate some conflicting ideas, which will cause the Chinese-funded bank to generate internal friction.

(6) Whether the factors of overseas financial institutions' shareholdings have a significant impact on the bank's net interest margin; the return coefficient of overseas financial institutions' shareholding ratio for net interest margin is significant, but its impact on net interest margin is not significant.

5. Summary and Recommendations

5.1 Summary

Based on the results of the regression analysis in this paper, we can draw the following conclusions: the participation of overseas financial institutions has a positive impact on the performance of China's banking industry. That is, the participation of overseas financial institutions can improve the profitability of the China's banking industry. However, due to some other factors, such as cognitive differences in management and constraints of relevant systems, the participation of overseas financial institutions has certain restrictions on the improvement of the profitability of China's banking industry. The positive impact of the introduction of foreign capital has certain limitations [6].

5.2 Recommendations

Chinese-funded bank has not had a definitive answer as to whether overseas financial institutions have a shareholding or a shareholding. Different people have different ideas, and some people think that they should vigorously introduce foreign capital, so that the China's banking industry can develop more vigorously, while some people think that the strong introduction of foreign capital may cause banks to be too affected by foreign capital, which will have a negative impact on the country's economy and sustainable development.

Regardless of the point of view, we all need some advice from Chinese banks:

(1) Improve the internal structure of Chinese-Funded Banks

From the regression analysis results in the previous chapter, the participation of overseas financial institutions has a negative impact on the bank's expense ratio, that is, the increase in the proportion of foreign financial institutions' shareholdings will cause the cost rate to drop. Among them, the most declining is the administrative costs of administrative enterprises. Due to the lack of domestic banking management experience, many banks are also hoping to introduce more advanced management experience and management models while attracting foreign investment. Learn from the excellent management methods of overseas financial institutions to improve the internal structure of the bank. Therefore, domestic banks should continue to strengthen cooperation with all aspects of overseas financial institutions while attracting foreign investment, learn from their national conditions, improve their internal structure, and enhance their competitiveness in the financial market^[7].

(2) Deepen interest rate marketization

From the results of regression analysis, the impact of overseas financial institutions on net interest spreads is not very significant. This is quite different from the results of foreign research on the same factors. The reason may be insufficient marketization of interest rates. China's interest rate marketization is still in its infancy. We should learn from the lessons of other countries at this stage and learn from the successful experiences of other countries at this stage to pave the way for China's development.

(3) Strengthen customer relationship management

From the comparison of different banks, the types of banks in China, no matter what type, the products in the banks are similar, there is no obvious feature. For the same bank, the bank offers similar products for different types of customers. Therefore, it is difficult for each bank to form its own distinctive products, and each product

cannot form an obvious target customer group, which has led to each bank not forming its own core competitiveness. Only when the target customers are identified, can the banks design their own products in a targeted manner and stand out when competing with other banks' products.

After the end of the product design process, the target customer will also be maintained. Let customers know more about their products, trust the bank brand, and build a stronger customer relationship. This kind of solid customer relationship can't be achieved only by the way that the bank now uses the customer's rebate.

According to the "28 Law", 80% of the profits come from 20% of the customers. The bank should pay attention to the research and communication of high-quality customers, and provide more personalized services for these high-quality customers, so as to improve the loyalty of quality customers^[8].

(4) Achieve product diversification

Although the profit growth rate of China's banking industry has been relatively high in recent years, its growth mainly comes from the higher credit gap and the expansion of credit assets. In addition, the non-interest income rate of the China's banking industry is less than 18%, and the same foreign indicator is twice that of the domestic market. The main source of profit for Western commercial banks is the intermediary business income.

As of 2004, overseas financial institutions have successfully implemented more than 100 kinds of wealth management products and services to China. The wealth management products and services launched by Chinese Banks are not even one-third.

The difference in the way banks operate at home and abroad also allows more customers to choose offshore financial institutions because they offer a wider range of services and a wider range of services.

Therefore, while accepting the participation of overseas financial institutions, Chinese banks can absorb the excellent experience of overseas financial institutions in the development of intermediary business, focus on the development and promotion of international settlement, personal wealth management and other services to achieve product diversification.

6. Conclusion

In general, the participation of overseas financial institutions will have a positive impact on the operating efficiency of the China's banking industry. Chinese Banks should strive to seize this opportunity. While introducing foreign capital, it must also introduce advanced foreign management concepts and management systems, adjust the internal structure of enterprises, and adjust the way

customer relationships are maintained, and design more abundant, comprehensive and personalized products and services, enhance their competitiveness, and strive to achieve a more important position in the international market.

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