A Strategic Assessment of CITIC Industrial Bank

by

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University of Manchester Institute of Science and Technology
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Submitted to the Sloan School of Management
in Partial Fulfillment of the Requirements for the Degree of

[ ] M.B.A.

Master of Science in Management

at the

Massachusetts Institute of Technology

December 1999

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Signature of Author

MIT Sloan School of Management
December 9, 1999

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Abstract

Important progress was made since Asia financial crisis in reforming China’s state-owned banks. CIB is an example of Chinese banks taking decisive steps to address their respective problems. This thesis concludes that banking reform in China can not rely solely on macroeconomics measures. A great deal can be achieved through incremental improvements in banks’ operation. At the same time, improvements in operation is also the ultimate guarantee for the long term sustainability of success in reforming Chinese banks. This thesis, using CIB as a case in point, points to recapitalization through incremental profit enhancement, management and organizational restructuring, implementation of management information system, development of marketing and distribution capabilities, and establishment of risk management system as the five effective mechanism to achieve results at individual bank level. This thesis also argues that CIB should reorganize its internal resources to make the transition to a consumer-centric banking model, and to re-evaluate and re-position its corporate banking business, taking into account the inherent and continually rising risk profile in the business.

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Title: Mitsubishi Career Development Assistant Professor of International Management
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CHAPTER 1 INTRODUCTION

Since the adoption of the “Open Door” policy in 1978, economic reform and restructuring have transformed many of China’s state sectors. However, little progress was made in the banking sector until 1997, when Asia financial crisis brought the regional economic and financial system, including that of China, to a standstill. It is not until then that the Government started to take a more comprehensive and decisive approach towards solving problems in the banking sector.

Traditionally, studies of Chinese banks concentrated on the macro issues such as the bad loan problem, the recapitalization strategy. Little research was carried out at the operational level. Consequently, the solutions suggested often place disproportional and unrealistic emphasis on system wide reform, at the cost of ignoring the importance of bank-level micro reform solutions such as operation improvement.

This thesis uses CITIC Industrial Bank “CIB”, the sixth largest state-owned national commercial bank by asset size in China, as a case in point to illustrate the importance of fundamental reform. This thesis points out that the key to achieve result in China’s banking reform is to initiate and execute re-engineering program at operation level i.e. investment in information technology and platform, organizational re-configuration, establishment of new human resources practices and compensation schemes, and establishment of modern risk management system.
CHAPTER 2 EVOLUTION OF CHINESE BANKING SECTOR

The traditional Chinese banking system has functioned as a State bookkeeper and an instrument for State economic policy. This is in contrast with the Western view of banking, where banking is seen as a competitive industry with goals of its own. The gap between the two systems has been slowly bridged over the past two decades of economic reform. Some changes have already taken place in the banking sector. For example, more and more Chinese banks are placing increasing emphasis on the bottom line as opposed to simply fulfil the "loan order" from central government. CIB has been recognized as a leader in this area. CIB became the first state-owned bank to open its book to international financial and investment community when it invited international strategy consulting firm McKinsey & Co. and the IT consulting arm of KPMG to design a firm-wide loan assessment and recovery system in 1997.

Since 1997, almost all Chinese banks, including the four largest state-owned banks, have taken important steps to address their respective problems. The actions taken range from the establishment of asset management firm by Bank of China to the initiation of the new incentive and compensation scheme by China Construction Bank. Smaller regional banks such as Bank of Shanghai has even taken the innovative step of providing on-line services to its customers. It is clear that Chinese banking structure and strategy are now evolving in a fundamental and far-reaching way. The strategic priority in the banking sector has firmly shifted from expansion to profitability, performance, and competitiveness.
The forces of change in Chinese banking are many. But none is as important as the changing regulatory framework. A marked feature of the banking reform in China during the 1980s and 1990s, in particular since 1997, is the evolution towards a more open, transparent, and contestable market. This process has been driven entirely by institutional changes at the state regulation level. Banking reform in China will continue to be defined and sculptured by the rapidly evolving regulation process.

In the following sections, the pre-1993 reform, reform during the period from 1993 to 1997, and post-1997 reform were presented in details. The division of timeline was decided principally with reference to the degree of maturity in the market forces. Prior to 1993, there was little evidence to suggest that Chinese banks were in any way influenced by the market. Between 1993 and 1997, it became increasingly clear that market forces, both domestic and international, were having an impact on the operational and strategic directions of the banks. The Asian financial crisis of 1997 was the event which plunged the whole of Chinese banking sector non-reversibly into the invisible hand of the market.
SECTION 2.1  PRE-1993 REFORM

The Chinese government started to reform banks in the late 1970s. At the time, all banks were state-owned and did not function at all as the intermediaries between savers and borrowers. The banking sector was dominated by the People’s Bank of China, which accounted for four-fifths of all deposits in banks and credit cooperatives and more than 90 per cent. of all the loans made by financial institutions.

Structural changes in the banking sector occurred only gradually. First, the People’s Bank of China was separated from the Ministry of Finance in 1978. The government then re-established the Agricultural Bank of China, the Bank of China, and the People’s Construction Bank of China in 1979. In 1983, the State Council designated the People’s Bank of China as the central bank, and established the Industrial and Commercial Bank to take over the People’s Bank of China’s deposit taking and lending business. This completed the first step of the banking sector reform in China. With the establishment of the so-called big four banks i.e. the Industrial and Commercial Bank of China, China Construction Bank, Bank of China, and the Agricultural Bank of China, China got its first batch of commercial banks. However, the word “commercial” is a bit misleading since the four banks have no real commercial objective other than taking deposits and making loans completely in accordance with the directives from the central government.
Over the years, the four major banks gradually expanded the scope of their services, and started to compete for depositors and lending services, although fixed rates implied little actual interest-rate based competition in reality. Also new financial institutions were being established. Most were joint stock companies whose shareholders were state owned enterprises or local governments. Two operated on a national level and they were Bank of Communications, headquartered in Shanghai, and CIB, a subsidiary of China International Trust and Investment Corp. Bank of Communications and CIB became the fifth and sixth largest state-owned national commercial bank.

Other new entrants were restricted to regional operations only, and most of them concentrated their businesses on the coastal region. None threatened the dominance of the four major banks.

Around the mid-1980s, several new types of non-bank financial intermediaries emerged and began to grow. These new entrants included urban credit cooperatives, trust and investment companies, finance companies associated with enterprise groups, financial leasing companies, securities companies, and credit rating companies. While small in size, these institutions later served as important catalysts for the introduction and establishment of competition in Chinese banking industry.
Despite the introduction of more commercially oriented new entrants, "policy lending" has remained a defining characteristic of the Chinese financial system.

<table>
<thead>
<tr>
<th>Institutions</th>
<th>1991</th>
<th>1993</th>
<th>1994</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Central Bank</strong></td>
<td>901</td>
<td>1,338</td>
<td>1,758</td>
</tr>
<tr>
<td><strong>Banking system</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>State Policy Bank</em></td>
<td></td>
<td></td>
<td>500</td>
</tr>
<tr>
<td>- State Development Bank of China</td>
<td></td>
<td></td>
<td>90</td>
</tr>
<tr>
<td>- Agricultural Development Bank of China</td>
<td></td>
<td>406</td>
<td></td>
</tr>
<tr>
<td>- Export-Import Bank of China</td>
<td></td>
<td>2</td>
<td></td>
</tr>
<tr>
<td><em>State Commercial Banks</em></td>
<td>3,714</td>
<td>5,540</td>
<td>7,498</td>
</tr>
<tr>
<td>- Industrial and Commercial Bank of China</td>
<td>1,117</td>
<td>1,959</td>
<td>2,633</td>
</tr>
<tr>
<td>- Bank of China</td>
<td>1,107</td>
<td>1,219</td>
<td>1,837</td>
</tr>
<tr>
<td>- Agricultural Bank of China</td>
<td>686</td>
<td>1,056</td>
<td>1,253</td>
</tr>
<tr>
<td>- Construction Bank of China</td>
<td>669</td>
<td>1,065</td>
<td>1,397</td>
</tr>
<tr>
<td>- Bank of Communications</td>
<td>106</td>
<td>196</td>
<td>305</td>
</tr>
<tr>
<td>- CITIC Industrial Bank</td>
<td>26</td>
<td>42</td>
<td>70</td>
</tr>
<tr>
<td><strong>Other Banks</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- China Everbright Bank</td>
<td></td>
<td>105</td>
<td>293</td>
</tr>
<tr>
<td>- Hua Xia Bank</td>
<td></td>
<td>9</td>
<td>20</td>
</tr>
<tr>
<td>- China Investment Bank</td>
<td>17</td>
<td>30</td>
<td>44</td>
</tr>
<tr>
<td>- Guangdong Development Bank</td>
<td></td>
<td>28</td>
<td>43</td>
</tr>
<tr>
<td>- Shenzhen Development Bank</td>
<td></td>
<td>9</td>
<td>15</td>
</tr>
<tr>
<td>- Pudong Development Bank</td>
<td></td>
<td></td>
<td>17</td>
</tr>
<tr>
<td>- Shenzhen Merchants Bank</td>
<td></td>
<td>15</td>
<td>44</td>
</tr>
<tr>
<td>- Fujian Industrial Bank</td>
<td></td>
<td>12</td>
<td>19</td>
</tr>
<tr>
<td>- Yantai and Bengbu Housing Savings Banks</td>
<td></td>
<td></td>
<td>4</td>
</tr>
</tbody>
</table>

Source: *Almanac of China’s Banking and Finance, various years*

In 1993 the government established three new "policy banks" to assume responsibility for those parts of the portfolios of the four large state banks that were devoted to non-commercially evaluated projects. This had the single largest impact on the big four
commercial banks and consequently, the big four would finally be free to pursue commercial objectives. At the same time, the State Council also encouraged the establishment of regionally based commercial banks. China Merchant Bank and Pudong Development Bank are the more prominent members of the group. However, in the beginning the number and the business scope of these new banking entities were restricted. It is not until mid 1990s that the new banks begun to be able to compete on equal footing with the state-owned giants. It is worth noting that even the new banks were still subject to considerable state control. This can be shown with the bank ownership structure below.

**Table 2.2 Shareholders in selected non-big-four commercial banks, 1997**

<table>
<thead>
<tr>
<th>Bank</th>
<th>Public Listed</th>
<th>Primary Government Shareholder (per cent. ownership)</th>
<th>Primary private shareholder (per cent. ownership)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of Communication</td>
<td>N</td>
<td>Ministry of Finance (57 per cent.)</td>
<td>-</td>
</tr>
<tr>
<td>China Everbright Bank</td>
<td>N</td>
<td>China Everbright Bank (100 per cent.)</td>
<td>-</td>
</tr>
<tr>
<td>China Investment Bank</td>
<td>N</td>
<td>China Construction Bank (100 per cent.)</td>
<td>-</td>
</tr>
<tr>
<td>China Merchant Bank</td>
<td>N</td>
<td>China Merchant Group (28 per cent.)</td>
<td>China Ocean Shipping Group Company (26 per cent.)</td>
</tr>
<tr>
<td>CITIC Industrial Bank</td>
<td>N</td>
<td>CITIC Group (100 per cent.)</td>
<td>-</td>
</tr>
<tr>
<td>Shanghai Pudong Development Bank</td>
<td>N</td>
<td>Shanghai Provincial Government (15 per cent.)</td>
<td>-</td>
</tr>
<tr>
<td>Shenzhen Development Bank</td>
<td>Y</td>
<td>Shenzhen Investment Administration Co. (10 per cent.)</td>
<td>-</td>
</tr>
</tbody>
</table>

*Source: Company Reports*
Another important factor which contributed to the speeding up of the banking reform process between 1993 and 1997 is the “soft-landing” initiated by the then Vice Premier Zhu Rong Ji in mid-1990s. In order to cool down the already significantly overheated economy, Vice Premier Zhu’s office imposed strict lending controls over the state banks and in fact, shut many of the speculative projects from credit sources completely. This led the whole banking industry to realize the extent of its excessive lending over the previous economic cycle. Almost immediately, the banks started strategically reviewing its lending practice, while frantically trying to recover their loan book. This is the first time that Chinese banks were forced to respond to the changing macroeconomic environment by changing their business conduct. This painful experience sent shockwaves throughout China’s financial system.

Around the same period, from 1993 to 1997, several new measures of monetary policy were being put into place. These new measures further strengthened the depth and pace of banking sector reform and they include provincial branches of the central bank relinquishing their role of granting loans to financial institutions, specific-purpose development loans from the central bank to non-financial institutions being cancelled, and ceiling on loans that commercial banks can get being lifted. Both the measures associated with the “soft-landing” program and the changes in monetary policies propelled Chinese banks to look away from the central government and look into the market place for signals and directions for the first time in their operating history.
But it is not until 1997, the arrival of Asian financial crisis, that Chinese banks and their regulator were seriously challenged to rethink the principals and foundations upon which the Chinese financial system has been built. The former incremental reform approach was replaced by giant restructuring plan.
Around the time of the Asian financial crisis, China has already been experiencing serious domestic economic problems for over a year. Rising unemployment, declining industrial profits and steady decline in state revenue income, among others, and were occupying the economic agenda of the central government. It was evident that the inefficiency of the State Owned Enterprises "SOE" was at the root of the domestic economic problems. SOE's poor performance accounted for much of the rising unemployment, as well as the decline in state revenue income. What kept the whole SOE sector going were the rolling bank loans from the state banks, which still channeled billions of consumer savings into the loss-making SOEs. The leadership of the Chinese government recognized this deep-seated cancer in the economic system: the detrimentally close relationship between loss-making enterprises and bankrupt state-owned banks. Something has to be done to change the de facto banking-enterprise relationship. Asia financial crisis sped up the whole banking reform process in China.

Having observed the neighboring countries' almost overnight demise, Chinese leaders were forced to set an aggressive agenda to put order into the country's financial system, in particular the SOE and bank relationship. One of the most significant banking reform measures is the removal of PBOC's 31 provincial branches and the establishment of 9 new cross-province branches in November 1998. Other significant measures included:
• the introduction of “State-Owned Commercial Bank Branch Offices Reform Act” with particular emphasis on the day-to-day management of the branches and sub-branches of state-owned banks;
• the abolishment of commercial lending quota, and increased emphasis on internal control and liability management;
• the reform and re-regulation of the commercial bank reserve requirement;
• the introduction of loan categorization pilot program in Guandong;
• the establishment of market value and risk models in commercial banks; and
• the proposed issuance of RMB 270billion special treasury notes for capital injection into the big four state-owned banks.

The purpose of these reform measures was to de-link central bank from commercial activities, to set the commercial banks free from the dominance of local influences, and to make commercial banks completely accountable for their own activities. It is during this period that banks such as CIB started experimenting with internationally practiced lending, loan recovery, and risk management processes. The Asian financial crisis firmly placed Chinese banking regulator and its players on an irreversible course of systematic reform. What is even more significant is that Chinese banks for the first time in their history are granted opportunity and freedom to pursue their strategic agenda. The pendulum of banking reform has now swung from the government and regulators into the hands of the banks. The establishment and development of CIB captured all the major components of Chinese banking reform from the early 1980s till present.
CHAPTER 3 DEVELOPMENT OF CITIC INDUSTRIAL BANK

During the early stages of economic reform, all Chinese banks were operated neither to serve retail customers’ needs nor to return profits to their shareholder. Their primary purpose was to channel consumer savings into cheap funding for strategic industries and companies. To that end, the government directed the banks to issue so-called policy loans at hugely discounted loan rates. Moreover, the banks’ performance was judged by the state on the basis of their lending volume, not their profitability.

By the mid 1980s, it became apparent that as a result of their overall importance to the economy, the big-four state banks were poorly equipped to support the increasingly rapid economic reform. The old banking system was simply unable to meet the credit demands of the new economy. To address these issues the government decided to create a new tier of commercial banks to reduce the economy’s over reliance on the big four, and to increase the availability of credit to the new economy. Given its special status during the early stages of China’s economic reform, China International Trust and Investment Corporation “CITIC” was chosen to play a leading role in the new banking restructuring.

CITIC was launched in 1979 when the State Council took the decision to adopt the now famous “open door” policy. Right from the beginning, CITIC was mandated to catalyze, and to lead the economic reform within the state sector. With its special access to the State Council, CITIC quickly grew to become the largest conglomerate
in China. Armed with the special mandate from the State Council from its founding days, CITIC was given the opportunity to play a leading role in each stage of China’s economic reform. The creation of CIB was an example of that. Even till today, CIB was one of the only two “new” banks created by the government to operate on a national scale. At the end of 1997, CIB’s total assets stood at RMB 125 billion with the balance of deposits amounting to RMB 102 billion.

The history of CIB spanned over the entire history of China’s banking reform. During the period, Chinese banking sector evolved from a monopoly of state banks into one where regional banks, private banks, and international banks compete more or less equal footing with the incumbents. The early stage of CIB was characterized by its relentless drive to expand its loan book and client base. During the period from the mid 1980s to the end of 1980s, based on a strategy of serving the blue-chips of Chinese corporate and meeting the international needs of the domestic economy, CIB grew into a powerhouse with an enviable list of clients. CIB came only second to

*Graph 3.1 CIB Profit before Tax 10 Year Trend*
Bank of China in its ability to attract and retain international business.

Into the 1990s, CIB was caught off-guard, like most of the other established banks, by the unexpected dramatic rise of consumer banking and the fall of corporate banking. Even though CIB maintained most of the momentum in its corporate lending business over much of the 1990s, it is clear that it has not been particularly successful in pursuing its retail banking agenda. Consequently, by the end of the decade, CIB has already been overtaken by a number of the latecomers on asset size measurement. Reading from the recent history of CIB, one can see that Chinese banks’ traditional business of taking deposits and lending out the proceeds is in terminal decline. On the liability side, investors are increasingly being offered the options to put away their money in a whole range of alternative investment vehicles. Mutual funds, government bonds, and the like are being offered on a daily basis. Even the basic savings products are now being deregulated. The spread of modern treasury management and
information technology has made it possible for the first time for the more advanced Chinese corporate to raise money in the domestic capital market. These twin pressures, coupled with low interest rates, have squeezed the banks’ profit margin—the difference between the rate at which banks borrow and lend. Even with CIB’s elite list of Chinese clients, the bank is struggling to keep up its loan book quality and profit margin. According to CIB’s management, its lending standard has been declining steadily for the past decade.

CIB is at an important junction in its corporate history. Going forward, much of CIB’s future depends on four factors. First of all, the future of CIB depends on how successful the organization can implement the far-reaching reform agenda the banks’ senior management is pursuing right now. Secondly, given the enormous capital needs of China’s economic development, serving corporate customers will remain the focus for Chinese banks during the next stage of China’s economic reform. CIB must consistently maintain and extract value from its current corporate client base. Thirdly, the retail business will grow exponentially and most of the growth will come from the expansion of the business scope. The consumer business presents CIB with its biggest growth and profit-realization opportunity. CIB must initiate and execute a sustainable long-term consumer business strategy. Last but not least, given government regulations will continue to be the single most important determinant for how fast both the retail and institutional businesses will grow, CIB should actively exploit CITIC’s unique position in China’s macroeconomic and financial structure and be ready to initiate and implement far-sighted corporate strategy.
CHAPTER 4 ASSESSMENT OF CIB CURRENT BUSINESSS STRATEGY
AND OPERATION

The above historical treatment of CIB demonstrates that in China, the old way of banking is gradually giving way to more vigorous, modern, and multi-product style of banking. Looking ahead, in order to compete successfully in the new economic environment, CIB must adopt a more sophisticated and diversified product strategy with greater emphasis on customer segmentation and service in both retail and institutional business.

In the corporate banking area, the key challenge for CIB, facing increased competition from both domestic and international players, is to develop institutional capabilities for evaluating and executing risk-adjusted banking practice in each of its main business lines, and to execute a customer-centric growth strategy. The bank should examine where they have been able to earn attractive risk-adjusted returns, and gear the whole organization to aggressively and effectively serve the appropriate market segments.

Much of the growth in Chinese banking lies in the retail market. In the retail sector, which has been historically under-represented in CIB’s business mix, the bank should set an aggressive internal mandate to rapidly establish a sustainable leading market position and to marshal resources to carry out such a plan on a long term basis. In this
Chapter, the current status of CIB’s two main revenue-generating areas, corporate banking and retail and card business, is described in details.

*Chart 4.1 Current CIB Organizational Chart*

<table>
<thead>
<tr>
<th>Headquarters</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of Business Development</td>
</tr>
<tr>
<td>Department of Real Estate</td>
</tr>
<tr>
<td>Jin Chen Branch</td>
</tr>
<tr>
<td>Guo Ji Branch</td>
</tr>
<tr>
<td>Department of Credit</td>
</tr>
<tr>
<td>Department of Trade Finance</td>
</tr>
<tr>
<td>Department of Trading</td>
</tr>
<tr>
<td>Department of Research and Analysis</td>
</tr>
<tr>
<td>Department of Accounts</td>
</tr>
<tr>
<td>Department of Credit Control</td>
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<tr>
<td>Department of International Finance</td>
</tr>
<tr>
<td>Department of Credit Card</td>
</tr>
<tr>
<td>Department of Audit</td>
</tr>
<tr>
<td>Department of Finance</td>
</tr>
<tr>
<td>Department of Compliance</td>
</tr>
<tr>
<td>Department of Information Technology</td>
</tr>
<tr>
<td>Department of President’s Office</td>
</tr>
<tr>
<td>Department of Education</td>
</tr>
<tr>
<td>Department of Policy Research</td>
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<tr>
<td>Department of Credit Management</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Local Branch Office Network</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai Branch</td>
</tr>
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<td>Hangzhou Branch</td>
</tr>
<tr>
<td>Weihai Branch</td>
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<tr>
<td>Qingdao Branch</td>
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<tr>
<td>Beijing Branch</td>
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<td>Jinan Branch</td>
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<td>Nanjing Branch</td>
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<td>Zhenzhou Branch</td>
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<td>Jiangsu Branch</td>
</tr>
<tr>
<td>Dalian Branch</td>
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<tr>
<td>Chengdu Branch</td>
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</tbody>
</table>

*Source: CIB Annual Report*
SECTION 4.1 CORPORATE BANKING

At the time of its creation, CIB was mandated to serve the bluechips of Chinese state-owned enterprises. CIB’s explosive growth during the early stages of its development is a clear vindication of the bank’s strategy as well as a reflection on the tremendous business opportunities in Chinese corporate banking sector at the time. The favorable trading conditions of the late 1980s and early 1990s such as the size of the potential clientele market, the lack of competition, the rapid economic growth, and the high margin nature of corporate lending all contributed to CIB’s early success.

However as the decade went on and China’s economic landscape started to change, CIB seemed to be unable to keep up its early growth momentum. Entering the second half of 1990s, CIB has been seen to have lagged behind its competitors in a number of hotly contested new markets e.g. housing loan market, credit card market, and general consumer financing sector. On the one hand, CIB was caught off-guard in the booming consumer credit business. On the other hand with its heavy reliance on its corporate banking arm to generate profit and growth, as the SOE sector outlook worsens, CIB simply can not maintain the same level of business growth and profit in the corporate sector as before. Consequently, the bank’s overall financial performance suffered
Section 4.1.1  Corporate Banking Sector Overview

According to International Monetary Fund, growth in Chinese domestic corporate lending grew by 374 per cent. over the period from 1990 to 1997. It is not until 1997 that it became evident that much of the explosion in commercial lending resulted from unsound lending at significant credit and default risks to the banks. Lending during the period was never priced on a risk-adjusted basis. In effect, a Chinese bank’s financial health is almost adversely correlated with the amount of lending business it conducts.

Section 4.1.2  Historical CIB Corporate Banking Revenue Model

CIB’s corporate banking profit came mainly from its lending business, deposit income, and foreign exchange and treasury activity. However this revenue model has been steadily eroded by the constant deterioration of the general corporate lending market, the competition in deposit acquisition, and the arrival of active corporate cash management.

**Lending Business:** between 1990 and 1997 the corporate banking business expanded dramatically. At the same time, margins looked good on numbers. From a Western perspective, where spreads on loans to Fortune 500 equivalent corporations are often 25 basis points or below and where even middle-market companies can access loans at less than 100-basis-point spreads over matched funding costs, all corporate lending margins looked attractive. However, in the absence of any credible systematic loan assessment scheme and without the benchmark of a meaningful capital market, it is difficult to know how high is enough. With hindsight it is clear that in most cases the
spread was significantly lower than what is necessary to justify the type of lending risks CIB was assuming at the time. But the high rates alone were enough an incentive for Chinese banks to engage in the explosive expansion of their loan books. With the dramatic increase in loan volume, coupled with high lending rate, CIB was able to book higher revenue and profit, at least on paper, year after year. However this situation was not sustainable and the Asian financial crisis brought it to an end.

**Deposit Income Dynamics:** Deposit income, the difference between the interest the banks were paying the corporate customers and what they had to pay to raise deposits or funding of similar maturity, was the single most important source of revenues for CIB.

In the West, cash management services offered by the banks and the increased sophistication of corporate meant that the Old World of customers leaving large amounts in non-interest paying accounts had long disappeared. But in China, corporate customers’ lack of sophistication, coupled with the fact that many simply could not be bothered with the day-to-day cash management, meant that banks can still earn a significant proportion of their profits from corporate cash deposits.

However, the spread of the modern treasury management and information technology made it possible for the first time for the more advanced Chinese corporate to manage their surplus cash in an active manner. This has led to a dramatic decrease in corporate cash deposits. Not only was CIB deprived of its most important profit stream, it was
also challenged to find funding in other places in order to satisfy the capital
requirement. Often this meant a steep increase in CIB’s funding cost. Indeed as one of
the senior managers in the treasury department pointed out that CIB’s challenge in the
new banking era is not just to find replacement for the lost revenue and profit streams
but rather to think strategically about how to maintain its current funding structure and
to minimize its funding cost. However, it should be pointed out that some increase in
bank funding cost is inevitable in a more liberalized and competitive market.

Foreign Exchange and Treasury Operations: In the beginning, there are only four
Chinese banks that can engage in foreign exchange activities. They are the Bank of
China, China Investment Bank, Bank of Communications in Shanghai, and CIB. For a
long time, Bank of China was the foreign exchange arm of the PBOC. Until the
establishment of CIB, China Investment Bank, and Bank of Communications, Bank of
China was the only financial institute with international business expertise.

The establishment of CIB signaled a new era in China’s international financial
business. For the first time, competition was introduced into China’s foreign exchange
service market. In the beginning, CIB still had to work closely with Bank of China.
But CIB’s business quickly expanded. The bank was allowed to raise funds abroad for
domestic investment project and was free to handle foreign exchange for itself as well
as its corporate clients. During the period from late 1980s till early 1990s, as more and
more Chinese enterprises increased their trade with the rest of world, there was a
tremendous demand for foreign exchange related services. The management of CIB
promptly recognized this extremely large and profitable market. With the rapid acquisition of skills and resources, CIB quickly established a strong franchise with reputation for product, service, and expertise in Chinese foreign exchange. Given the large pool of potential clients, CIB was able to pick and maintain some of the most attractive Chinese clients in the foreign exchange service market. Over the years, foreign exchange operation and its associated treasury activities have contributed significantly to CIB’s bottom line. However, more and more Chinese banks are now able to offer similar services and almost all compete with CIB on pricing, products, and services. It is difficult to see how CIB can differentiate itself from the competition and enjoy its leading market position in an increasingly competitive segment without increased focus and resources. In short, CIB’s traditional revenue and growth model in the corporate sector is being seriously challenged by the rapid changes in the market place.

Section 4.1.3 Operating Expenses and Loan Losses

To generate various revenues, banks incur operating costs and potential credit or trading losses. Operating expenses are reasonably straightforward and fall into three broad types: those directly associated with the business; those shared with other businesses; and those spread across numerous businesses.

During the period from 1995 to 1997, CIB registered an average cost-to-income ratio of around 22 per cent. During the same period, the comparable cost-to-income ratio for major bank in the U.S. and U.K. is in the range of 50 per cent. to 65 per cent. A
direct comparison between the Chinese operating number and their Western counterparts gives little insight into the operating characteristics of Chinese institutions. While Chinese banks still derive the bulk of their income from their corporate lending business, the revenue generating activities of Western banks today span from trading in global market to selling bundled wealth management products to mass market. Furthermore, there are major differences in the cost of conducting banking business in China and Western countries. These differences in cost base range from wages differential to more complicated differentials in total social benefits packages.

One important conclusion from the above comparison is that Chinese banks’ very low cost-to-income numbers masked a real problem for the banks i.e. a major under-investment in systems. Investments in the banks’ infrastructure and system in order to meet the competitive pressures of the new banking environment will inevitably push the cost-to-income numbers to a much higher level. Furthermore, the trend of migrating the provision of employee benefits from the State to individual firms will also increase the operating cost of the banking business in China. Therefore, even with the generous assumption of steady revenue income, CIB’s corporate banking profitability is set to worsen as a result of anticipated jumps in investment and provision charges.

System loan losses during the years preceding Asian financial crisis is wide-spread in China due to much publicized channeling of funds through state-controlled banks by
the government. Although China still has not published a reliable estimate of its bad
depts within banking sector, a conservative estimate of non-performing loan is in the
range of 25 per cent. to 35 per cent.

Section 4.1.4  Competition in Corporate Banking

With competitive challenges from the lending business and foreign exchange and
treasury activities, and despite the entire bad loan problem, corporate banking remains
at the core of CIB's strategy. Why is the business so attractive? The answer is simple
that for the most part of its history, corporate banking is CIB's only revenue channel.
Even today, consumer-banking is still less developed by comparison, while asset
management, private banking, and other more sophisticated consumer banking
products are still non-existent.

Historically, all the major players in Chinese banking poured their resources into a
fundamentally unhealthy and shrinking segment of the economy: state-owned
enterprises. It is not until mid-1990s that Chinese banks started to recognize the
fundamental problems of placing too much emphasis on the corporate banking alone.
Heightened competition and intensified risk profile precipitated these phenomena.
From the late 1980s, Chinese regulator started to allow the establishment of regional
banks as well as other financial companies. The introduction of new and more focused
players exerted considerably more pressures on established national players such as
CIB. These new banks not only do not suffer from the historical problems of bad loans
but also are more aggressive in their business development strategy. They often
compete with CIB directly for CIB's most treasured client business in foreign exchange service, trade finance, and treasury management. At the same time, the growth opportunity in China also encouraged some international banks to put China firmly on the agenda for growth. As a result, these foreign banks increased their regional resources and started, albeit within limited scope, competing with local Chinese banks for banking customers. These multinational banks focused most of their capabilities and resources on serving multinational company and in some case, more credit-worthy local large enterprises. As a result, returns in these segments of the corporate banking business started to decline sharply. The new competition, from both domestic newentrants and foreign players, eats into the profit margins of established banks and left them with poorer credit profile and weakened capital structure.

PBOC still tries to provide maximum protection for domestic banks but it can no longer shield CIB completely from competition. The reality is that in corporate banking, competition is already affecting the returns of the local banks. In order to retain market, domestic banks extended credits to companies that simply did not warrant it. Increased competition and rise in risk profile accounted for much of the worsening of domestic banks’ loan book. In summary, unfavorable corporate client banking behavior and the introduction of new competition, both domestic and foreign, are adversely affecting CIB's corporate business. Without a systematic analysis of its historical risk-adjusted loan performance, CIB attempted to maintain its revenue and profit momentum through indiscriminate expansion of its client base. This strategy accounted for the worsening of CIB’s loan book quality as well as its profit level.
SECTION 4.2 RETAIL BANKING

In 1997, China's retail market was the largest in Asia ex-Japan, with retail balances amounting to US$475 billion. Government regulations limiting savings options and consumer credit availability ensured that most of the available retail deposits would ultimately be channeled to corporations. As a result, 82 per cent. of personal savings were held in deposits, compared with 40 per cent. in Korea and 48 per cent. in Singapore. Consumer loans were also virtually non-existent, representing only 1 per cent. of the total retail balance. Until recently, much of China's retail banking sector seemed to have stagnated as the Chinese economy transitioned from an agricultural economy in 1978 to an industrial economy today. The improvements in income, living conditions, and access to technology among consumers seemed to have limited impact on the development of retail market. Even less progress on offering integrated product lines and servicing different customer group was observed. However all these are set to change. The new changes will pose fundamental challenge to Chinese banks on their long-term growth strategy.

Section 4.2.1 Retail Market Overview

A three-tier retail market is quietly forming in China. A small percentage of the population is breaking away from the rest of the population. Increasingly, this group of people will be subject to intense marketing battles in retail business. This same group of people is also likely to demand a higher level of service and product from their traditional banks. While small in absolute numbers, around 2 per cent. of the total
population, this group of successful Chinese contributes around 25 per cent. of the total deposits in the system. Their absolute small size and high cumulative wealth makes this group of consumers an extremely attractive segment of the market to service. Enormous growth opportunities exist in this segment, from straightforward consumer loans to private wealth management, and they represent the most attractive opportunity for CIB’s growing retail business.

A second group of consumers, much larger in number than the first group, is also enjoying rapid economic growth. This consumer group in China accounts for 21 per cent. of the population. Collectively this group of people accounts for 35 per cent. of retail banking deposits.

The final and largest group is the rural market. This group saw relatively high-income growth but from a very small base. Their banking needs are small and can be met sufficiently by state-owned institutions with large national networks.

However, given the historical status of Chinese retail banking structure, little product or market differentiation is offered to the different customer groups. Chinese retail banking has long been dominated by the big four that had the most extensive branch network. Collectively, the big four controlled a majority of the consume deposits, and viewed consumers as nothing more than an inexpensive source of funding to finance their corporate lending activities.
Section 4.2.2 Recent Development

Starting in mid-1990s, more and more competing investment and savings products were introduced to the retail market. Chinese banks start to recognize that they could no longer afford to be passive with their consumers. A combination of narrowing corporate lending spreads, growing competition for deposits, and increasing customer sophistication made clear to most incumbents that concerted efforts on retail banking are imperative for them in order to preserve their profits and market position.

However given its historical root in corporate banking, CIB has been slow to identify and capitalize on the opportunities in the consumer market. Even though CIB is one of the six banks in China with a national mandate, it has neither developed the national retail franchise as the big four has, nor captured its regional home market as Bank of Communications does. CIB’s lack of physical presence in the retail market is further compounded by the absence of a clear and consistent strategy on the corporate level.

New players such as China Merchant Bank, Ming Shen Bank, and Everbright Bank competed aggressively to establish themselves in the retail market. All of the new banks are local players by charter and tend to serve one or two geographic areas only. In most cases, these geographic areas overlap with CIB’s limited local coverage. Without the benefit of a captured corporate client base, the new banks identified and rightly chose the retail market as their battleground against the more established state banks. They identified the targeted consumer groups, rolled out extensive local branch network, introduced more personalized banking services, and introduced new product
lines whenever regulation allows. All these efforts translated into huge jumps in the new banks’ deposit base. Between 1995 and 1997, CIB registered annualized growth rate of 22 per cent. in its deposit balance while Ming Shen Bank recorded almost twice as much. By comparison, CIB has been slow, seen by many industry observers including some of CIB’s own senior managers, to adopt a more aggressive approach to establish a corporate strategic plan for the retail market. CIB’s absence in the retail payment business and consumer credit market are two prime examples.

**Deposit Business and Payment System:** Traditionally, Chinese banks do not fight for deposits. Chinese consumers entrust their deposits with one of the national banks and the banks in turn hand out loans to designated state enterprises. However this passive deposits gathering and redistribution system is currently being challenged by the introduction of new players, popularization of stock market, as well as the arrival of a national payment system.

As of 1998, China had no checking system and no national system to clear retail payments. China is still heavily dependent on cash at the end of the 1990s. Nearly 70 per cent. of all transactions were settled in cash, and for the average consumer the figure was closer to 100 per cent. For Chinese businesses and consumers, completing basic transactions was a major headache and there was a large and unmet demand for an efficient payment system.
In response to this demand, the government sponsored a series of projects to create a nationwide payment system based on smartcard and ATM technology – the "Golden Card" projects. These efforts focused on creating a multi-bank ATM networks in major cities built around a common electronic clearing and settlement network. Most banks responded enthusiastically by offering combined ATM and debit cards linked to deposit accounts. From a base of zero in the early 1990s, 40 million cards were in circulation by 1997. Of these, about 50 per cent. has some, generally small, credit line attached to the account, and for many Chinese it was their only source of consumer credit. Despite the lack of a nationwide ATM system, these smart cards have become an important part of the national payment system. In 1996, approximately US$130 billion worth of transactions were completed on bankcards in China, making China the largest card market in Asia outside Japan.

For domestic banks, transacting accounts is highly profitable. Banks that are able to create broad and accessible ATM networks capture and retain high margin deposits. In 1997, Chinese consumers and corporations held nearly US$13 billion in deposits linked to cards. Including fees, float earnings, and overdraft interest, the average annual revenue per card account was about US$45. After deducting variable costs and credit losses per account, it is estimated that the average card account generated US$25-30 annually. The new entrants such as Ming Shen Bank saw the enormous opportunity in this market and invested heavily in its system and capability. These same banks also started focusing on customer service and product offering to lure
deposits. By comparison, CIB missed out most of the debit card and related credit business.

**Development in Consumer Credit:** At the moment, there is the near absence of consumer credit products in Chinese banks. This is due to PBOC’s strict limits over consumer credits. At the moment, PBOC sets limits on borrowing at US$1,200 and US$600 respectively for gold and standard credit card holders. The maximum time overdraft balances could be outstanding is 60 days, and the interest rate rises sharply after day 15. For a full 60-day balance, the effective annual interest rate is approximately 30 per cent. The average overdraft card in China had about US$10 outstanding, creating about US$400 million in consumer assets for the entire banking system. There were probably fewer than 100,000 true domestic credit cards in China at the end of 1997s. Given the restrictive nature of the card business, most consumers still regard credit card as a minor supplement to their cash transactions. However, some Chinese banks have been actively exploiting this new business to lure customers and to bring in deposits, which tend to attract the first group of retail consumers, the well-off group.

The home mortgage program, in contrast, was encouraged by the government. As part of the effort to restructure the SOEs, the government tried to reduce SOE liabilities by encouraging private home ownership. China Construction Bank started mortgage lending in 1992 and mortgage terms were adjusted several times in favor of the borrowers between 1992 and 1998. At the end of 1998, the maximum loan amount
was increased to 70 per cent. of the property value, and the maturity was extended to a maximum of 20 years. Furthermore, all local banks were permitted to offer mortgages. As a result of the policy changes, mortgage loans became by far the largest category of personal financial assets in the banks, representing more than 85 per cent. of total retail loans at the end of 1997. Competition for mortgage businesses was also fierce. All the banks attempted to simplify application and monthly payment processes. China Construction Bank and Industrial and Commercial Bank of China began advertising on TV for their mortgage businesses. By contrast, CIB appeared to have failed to appreciate the significance of the mortgage lending market.

CIB's lackluster performance in corporate banking, coupled with its lack of strategic initiative in the retail business, gave rise to the concerns over CIB's long term position and profitability in the industry. Can CIB restructure itself and start a course of recovery and prosperity? If so, what are the possible channels for achieving that goal. The next chapter, Foundation for Success, attempts to answer these questions.
CHAPTER 5 FOUNDATION FOR SUCCESS

Successful banking strategy comes from solid operation and indeed it is the operation which poses as the single biggest challenge for CIB as the bank makes the transition from a state-directed entity to one which needs to focus on customer, competition and market. CIB as well as its domestic competitors does well by putting its house in order before setting out for higher ambition. Chinese banks need to set new strategic directions for themselves. The new strategy will entail a level of focus on operation and execution which has been absent in Chinese banking.

This chapter lays out the essential elements for CIB to achieve success in the coming decade. They include recapitalization through incremental profit enhancement, management and organizational restructuring, implementation of management information system, development of marketing and distribution capabilities, and establishment of risk management system.
SECTION 5.1   FINANCIAL STATUS OF CIB

It is a well-know fact that Chinese banking problem is one of the most serious in the world and is described by some observers to be close to the point of systematic bankruptcy. Restoring the banks' financial health is the immediate over-riding objective in the banking sector and should be the focus of all bank operations.

In this section, the current financial health of Chinese banks is discussed. While capital injection no doubt remains as the single most important component in the restoration of the banks' health, incremental improvements, those deriving from improved operations, should constitute the core of the recovery strategy. Without sustained improvement in the banks' operation, any one-off capital injection is likely to be eroded away by the malpractice eventually.

Section 5.1.1   Current Status

There is much speculation on just how bad, as measured by bad loans, is Chinese banking system. Two questions are obvious in this context. The first question is what fraction is nonperforming? Speculation on this ranges around 20 per cent. of the state bank loans. At the same time, Standard & Poor estimates that the true level is around 4 per cent. Wilder guess goes as high as 40 per cent. The second question is that of the nonperforming loans, what fraction is irrecoverable? This is entirely unknown. Pessimism about the quality of SOEs leads to numbers that might be as high as 50 or
even 70 per cent. The effect of combining these two considerations suggest an enormous cost of banking sector restructuring.

Little is known about the status of CIB’s loan book. Some CIB managers suggest that since the bank only came into existence in mid-1980s and therefore the bank should be less burdened with bad loan problem. However a different pointview is that: the huge jump in bad lending took place mostly in the 1990s. This is precisely the period during which CIB grew the fastest. The net effect of having had little historical bad loan and supergrowing the loan book in the 1990s meant that CIB has probably only slightly less bad loan on a percentage base when compared to the big four.

Section 5.1.2 Strategy for Recapitalization

It should be said that the scope and scale of any bank’s recapitalization program hinges on the scope and scale of broader Chinese economic reform. It is highly unlikely that CIB itself can initiate and implement a comprehensive recapitalization plan without consultation and/or approval from the central government.

As a first step, the senior management of CIB, together with the leadership of CITIC Group, needs to form a team to draft a plan that broadly describes its future business strategy, works out the corresponding revenue and income projections, and categorizes loan losses. Recapitalization must take place in the context of ongoing review of the current business portfolio and future strategic direction. Over the past 18 months, with help from international professional firms, CIB has been systematically reviewing its
existing business portfolio, in particular the status of its loan book. This is an important first step towards understanding the extent of required recapitalization.

Once the recapitalization plan has been drafted, senior management should then convene a team to identify capital-raising options, for example, raising equity in domestic or international capital markets, one-off injection of equity from CITIC Group. Given the nature of banking business in China and the extent of bad loan situation, it is unlikely that CIB/CITIC Group can execute a recapitalization plan independent of the central government. However, the good news is that China has only negligible public debt and no domestic debt to speak of. Thus the bank clean-up essentially represents a one-time creation of public debt. If depositors are to be protected, the government needs to put net worth guarantees equal to the bad loans in the banks’ balance sheet. What is worth pointing out is that Chinese bank restructuring should go hand in hand with the creation of a national capital market for both debt and equity. The recapitalization itself needs a capital market in which banks can see the government’s recapitalization bond over time. And banks need competition to determine a sound benchmark for the cost of credit and spread between deposits and loan rates. When credit is repressed and all rates are administrative, mis-pricing of credit is endemic and can build up to very large problems in balance sheet just like what happened in China over the past two decades.

In summary, a fuller understanding of CIB’s current financial health, coupled with a strategic roadmap for the bank’s long term business development, will help to
establish a clear agenda for CIB’s recapitalization. A combination of government
directed recapitalization program and CITIC Group initiated capital injection plan will
be required to restore CIB’s financial health to a status necessary for a full competition
in the dynamically changing domestic banking sector. However CIB itself does not
have control over the outcome of the above two solutions. Furthermore, without a high
level of operational competence, any one-off recapitalization progress is likely to be
eaten away by inefficiency or in the worse case scenario, be upset by a catastrophic
event due to some operational negligence. Therefore to tackle the deep seated
problems of Chinese banks, the solution must go beyond repairing the banks’ balance
sheet alone. Part of the recapitalization must address the banks’ operation
comprehensively. Without a new set of operation system and standard, even
recapitalized banks may drift into difficulties again. Indeed the long-term success of
CIB’s reform program depends on successful execution more than any other factors.
Both domestic bank watchers and their Western counterparts often put disproportional
amount of emphasis on the strategic side of China banking reform at the expense of
ignoring the importance of operation. However, a more careful examination of the
situation will conclude that despite of the rigidity of the regulatory framework,
Chinese banks have a great deal of scope within their operations to improve the
overall standard of their business. And improvements on the operation side of the
business will be a deciding factor on determining the outcome of China’s banking
reform. In the next few sections, five major components of CIB’s operation are
examined in details. These five components are management structure, marketing and
distribution, information technology and structure, processing and risk management.
SECTION 5.2  MANAGEMENT AND ORGANISATIONAL STRUCTURE

The most important safeguard against unsound banking is competent management. Regulation and supervision, no matter how carefully designed, can not guarantee that a bank is well run. Senior bank managers need to possess a high degree of integrity, adequate training, experience and control over credit approval and risk control procedures. But all this will not be enough if managers do not have the right incentives and boards of directors do not exercise effective control over management.

Up until recently, Chinese banks employ very little incentive scheme to reward their managers. In CIB' case, the most senior member of the bank receives an aggregate compensation package no larger than 5 times of a recent graduate joiner. Instead senior managers tend to be rewarded in other perks e.g. cars, housing allowance. At the same time, senior personnel appointment tends to be determined by party process rather than on managerial merits. Given the political nature of the appointment, these same senior managers or board member often do not align their personal objectives with the financial performance of the bank. The failure to incentives competent managers and to align their interests with the financial performance of the bank, compounded by the bank's failure to appoint effective supervisors, accounts for many of the difficulties Chinese banks came across in their reform programs. This old style of personal and reward system looks increasingly at odd with the competitive and market-oriented nature of Chinese banking.
Since 1997, as part of the overall study of CIB’s loan portfolio, CIB has taken incremental steps to address the incentive system, in particular in the credit assessment and loan recovery departments. Part of the new incentive structure is that credit managers will be rewarded in three ways: formal incentives such as cash bonus; career progress inside and outside the firm, which encourage forward looking individuals to work hard and to think about their future; and other benefits. CIB top management has broadcasted to the entire staff their determination of “rewarding performance in a way which has never been envisaged before, including having no caps on the amount of cash bonus granted to significant revenue achievers.” Total compensation now constitutes significant bonus component, determined as a function of the bank’s performance. Internal debates indicate that the new incentive scheme is already having a dramatic impact on motivating the employees in particular the front line operators to achieve results.

However, incentives alone are not enough. Board of Directors have a crucial role in controlling managers and monitoring bank’s performance. To make sure that they do this effectively, boards should be organized in special committees with identifiable responsibility e.g. internal auditing, credit approval procedures. Board members’ compensation should also depend on performance. It is understood that CIB has recognized the importance of an independent and strong board and is in the process of initiating a broad restructuring.
A third challenge for CIB is to extend the new performance related pay structure to all staff. Possible solution is that depending on the particular department they are in, they can be rewarded based on a variety of performance benchmark such as growth, profitability, and customer satisfaction. Discussion with CIB’s managers indicates that there is almost universal recognition within the bank that incentive and human resources system have to be modified to facilitate the new banking dynamics. It is suggested that the possible IPO of CIB will catalyze these important changes.
SECTION 5.3 MANAGEMENT AND INFORMATION SYSTEM

It is predicted that the annual information technology related investment in Chinese banking sector is going to exceed 40 per cent. Per annum. More and more banks start to recognize the strategic importance of IT enabled corporate choice. Winners and losers will be distinguished by their ability to improve their operation efficiently within the new IT structure. At the same time, the corporate banking environment in China is evolving into a more transparent and competitive one, each bank will have to seek its own customer base or product specialization. In its chosen market, a bank must access the best information on the risks it is taking, consider how it will evaluate those risk with respect to the bank’s overall business portfolio. Superior information management and utilization will be a critical element of success.

Historically, Chinese banks placed little emphasis on information technology “IT” and management. In many ways, Chinese banks are still at the very beginning of the IT and management information system “MIS” learning curve. IT or MIS are still thought to equate to “automate” in China. Indeed, “to automate” has been the cornerstone of IT strategy for many Chinese banks. However, there are signs that Chinese banks have started taking notice of the “inform” element of the IT investment in the broader business context.

Comparing to its competitors, CIB has been early in recognizing the importance of effective information management. This recognition is further enhanced as the bank
moved aggressively to reorganize its loan portfolio. In 1997, CIB hired international consulting firm McKinsey and Co. and KPMG Consulting to assist itself to develop a sophisticated internal information assessment and management system. It is reported that “CIB’s MIS strategy is now to win the business we target, manage credit effectively, and have the ability to monitor bank’s strategic targets effectively through MIS.”

The new focus on the management and utilization of information has also had an impact on CIB’s organizational structure. While making heavy investment in the system, CIB has taken a number of steps to reorganize its internal structure to leverage on the information infrastructure. CIB centralized its entire local/provincial credit departments, tightened control over local credit and loan recovery operation, and installed a direct reporting line between the head office credit department and the Group President’s office. CIB has also established a group-wide credit approval policy, and is now in the process of applying the new credit methodology across the entire national network. Universal credit approval processes will be applied to all clients in each business and geographical unit on a new IT platform. CIB is also using MIS to analyze its loan portfolio on a sector by sector and region by region basis. In serving small-business customers, CIB is considering introducing statistically driven credit-scoring system to help systemize and rationalize the credit approval process.

Finally, the new MIS will eventually be implemented across all segments of CIB’s business portfolio from corporate loans to consumer credits. By so doing, CIB will
know in the future where they are lending, and what the total returns will be on risk-adjusted basis. All loans will be coded by industry and collateral type, maturity, and repricing structure so that credit units can undertake simple tests of portfolio sensitivity to new economic conditions.

What is most exciting from discussion with senior CIB managers is that the bank now intends to utilize the feedback from the IT and MIS systems to dynamically assess its strategic business direction. Citicorp, now CITI Group, went through the same exercise during a critical period of its development. The change in Citicorp’s business mix between 1980 and 1988 was significant. Citicorp increased its level of consumer loans from 22 per cent. To 55 per cent. Of its loan portfolio in this period. The important feature is that these loans command wider spread than corporate lending and also require fundamentally different skills. The consumer lending is a more mass market, mass production environment. This is where IT and MIS technology can be brought to bear. The technology can assist in the operations aspect and lead to improved productivity. If the advent of technology can be seen to improve efficiency and effectiveness in certain lines of banking business then this may cause a fundamental shift in the product mix and lead to higher returns in the net interest line of the profit and loss account. Perhaps it has became clear to CIB managers, investing in technology was not only important in maintaining a high level of operation efficiency but also instrumental in assisting the bank make the necessary strategic shift. This is indeed the motivation behind the CIB’s enthusiastic embracement of the new MIS and IT systems.
SECTION 5.4 MARKETING AND DISTRIBUTION

Given the culture of Chinese banking, it is no surprise that little emphasis was placed on marketing and distribution. Chinese depositors faced with neither alternative savings product choice nor service differentiation, routinely deposit all of their savings into one national bank. Marketing and distribution, characterized by a high degree of customer-focus service as exampled by Western banks, are all but missing in China.

Traditionally, Chinese banks did not fight for depositors. Most depositors did not switch their banks either since almost all banks were offering more or less the same product with the same level of service. However, as the domestic retail market starts to take off, along with the introduction of alternative savings and investment products, more and more Chinese banks are now having to put increased emphasis on acquiring the customers. Fighting for consumer deposits becomes even more critical for those banks such as CIB facing deteriorating corporate deposits.

While the senior managers recognized the strategic importance of broadening CIB’s reach in the retail market, CIB as an institution was ill-equipped to deal with this new challenge. CIB lagged behind the big four, noticeably China Construction Bank, in its retail strategy. China Construction Bank not only aggressively leveraged on its extensive national franchise to win customers, but also resorted to more modern marketing techniques such as TV Champaign to influence consumers.
Going forward CIB needs to initiate and execute an aggressive consumer-centric expansion strategy. The consumer-centric strategy extends from the straightforward savings product, to private wealth management, and other consumer financial products. And using technology to enhance CIB’s distribution and marketing capabilities should be an important element of the overall plan. Technology should, in theory, allow banks to market and deliver their products more cheaply than traditional branch networks. That was the rationale for banks introducing ATMS in the 1970s, telephone banking in the 1980s, and now Internet banking. Probably 85% of banks around the world, and nearly 100% of American banks, have Internet sites. Citigroup is spending about $200 million a year developing its Internet presence.

Establishing marketing capabilities are imperative for CIB to combat the ongoing battle for consumer deposits and other related financial products. More importantly, it is critical for CIB to refashion itself into a new institution with balanced portfolio of consumer and corporate businesses. Enhancing traditional marketing and distribution network, while making leapforward in using technology to extend the bank’s marketing and distribution reach, remains at the core of the bank’s new strategy game plan.
SECTION 5.5 PRODUCTIVITY

Due to historical reasons, China’s state banks suffer from low manpower efficiency and are hugely overstaffed by western standard. However given China’s preoccupation with social stability, so far only few selected SOEs have been able to implement any meaningful redundancy plan. In reality, it has been virtually impossible for banks such as CIB to dismiss any employee, regardless of bank’s overall financial health or employee’s performance. At the same time, the wage cost has escalated, with base salaries edging upwards each year by over 10 per cent. On average over the past five years. This structure of high rigidity and high cost per revenue is no longer sustainable in the current competitive environment. It is understood that banks, in particular those with potential for capital market listing such as CIB, are now starting to reassess their productivity issues. At the least, the banks expect that normal attrition and retirement will be allowed, coupled with hiring freeze except in the area where high-skill jobs are warranted, the headcount can be kept from rising any further. It is learned that CIB has also been simultaneously establishing measurement and benchmark to increase the productivity of its system and staff. So far, the push for high productivity has targeted mainly at the front line business units such as credit department and the efforts were tightly integrated with the introduction of new incentive and compensation schemes. The bank’s senior managers expect significant productivity improvements, measured by quality loan assessment, lending, and recovery, over the next couple of years.
SECTION 5.6 RISK MANAGEMENT

Following the Asia financial crisis, there is renewed emphasis on the importance of risk management among Chinese banks. CIB has been particularly active in managing its overall risk profile. Over the past two years, CIB worked with a number of international professional firms on a firm wide risk management system.

It is clear from discussions with CIB’s senior management that the bank is no longer satisfied with running the business on a local basis. The demand of the market and the need for a consolidated view of its business and risk profile led CIB to reorganize its lending activities on a functional or firm-wide basis in 1998. One of the key objectives of the reorganization is to establish a risk management process which is independently operated from other business functions of the bank. Having said that, when comparing CIB’s risk definition and management structure to the seven risk categories defined by the Basle Committee and IOSCO in their 1994 papers, it can be seen that CIB has not fully comprehend the full scale and scope of a necessary firm-wide risk system.
<table>
<thead>
<tr>
<th>Risk dimension</th>
<th>Definition</th>
<th>Managed by</th>
<th>CIB practice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market risk</td>
<td>The risk to an institution’s financial condition arising from adverse movements in the level or volatility of market prices</td>
<td>Providing consistent information of market risk across the organization at all levels; calculating consistent risk measures; establishing appropriate procedures and monitoring risk limits; and understanding where risk comes from across the organization</td>
<td>Limited exposure to international trading risk; negligible domestic trading position; both risks consolidated by treasury department and managed directly by one of the six vice presidents of the bank</td>
</tr>
<tr>
<td>Credit risk</td>
<td>The risk that a counterpart will fail to perform on an obligation owed to the firm</td>
<td>Monitoring credit exposures relative to limits; resetting limits regularly; and scenario analysis</td>
<td>Initiated credit-scoring system recently; intending to roll out the new credit system to the bank’s entire national franchise within the next 18 months; no historical precedent/expertise in this area</td>
</tr>
<tr>
<td>Settlement risk</td>
<td>The risk that a firm will not receive funds or instruments from its counterparts at the expected time</td>
<td>Monitoring counterpart activities and settlement limits; and managing resettlement counterparts exposures</td>
<td>Dealing with credits of higher standing than CIB in most international trades; no major international losses; domestic situation unknown</td>
</tr>
<tr>
<td>Risk dimension</td>
<td>Definition</td>
<td>Managed by</td>
<td>CIB practice</td>
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<tr>
<td>Liquidity risk</td>
<td>An institution faces two types of liquidity risk: one related to specific products or markets, the other related to the general funding of the institution's activities. The former is the risk that an institution may not be able to, or can not easily unwind or offset a particular position at or near the previous market price because of disruptions in the market. Funding liquidity risk is the risk that the institution will be unable to meet its payment obligations on settlement.</td>
<td>Actively matching funding horizon of debt to liquidity of positions; and developing liquidity guidelines to limit exposures in asset classes and instruments</td>
<td>As a result of the changing corporate banking behavior, the bank has been experiencing significant funding fluctuation; no clear strategy at this stage on how best to migrate funding and liquidity risk; limited efforts in broadening funding sources; no reported product delivery difficulties so far, possibly because of limited overall trading position and product portfolio</td>
</tr>
<tr>
<td>Operational risk</td>
<td>The risk that deficiencies in information systems or internal controls will result in unexpected loss. The risk is associated with human error, system failures and inadequate procedures and controls.</td>
<td>Establishing proper supervision and segregation of duties; testing all systems in a comprehensive manner; establishing complete reconciliation between internal and external systems; and setting up complete independent backup facilities and systems</td>
<td>Moving towards proper supervision and segregation of duties in particular in credit related areas; lack of efforts on general backoffice operation risk control and mitigation</td>
</tr>
<tr>
<td>Legal risk</td>
<td>The risk that contracts are not legally enforceable or documented correctly</td>
<td>Carefully contracting and conducting business with external parties and employees; and establishing clear compliance and regulatory structures</td>
<td>No significant legal risk domestically mostly because of the less developed client-bank relationship and legal system</td>
</tr>
</tbody>
</table>
Having examined the status of risk management in CIB, it is now appropriate to make a direct link between CIB’s long term strategic plan and its risk profile. For financial firms, the role of risk management has an overwhelming impact on internal capital allocation, which in turn dictates the corporate strategy. Furthermore, risk management also plays an important role in the wider context of maximizing shareholders value. CIB faces considerable challenges on both fronts.

The primary focus in corporate financial management is to maximize the risk-adjusted returns generated for the providers of the capital. In applying this objective, an investment should generate a positive net present value after discounting the expected cashflows. In order to measure how much value has been generated and where, three parameters need to be determined;

- the returns earned or expected to be earned,
- the amount of capital actually invested or tied up in a particular business portfolio, transaction; and
- the appropriate risk-adjusted cost of the capital involved.

In the case of CIB, historically, the first two benchmarks were registered, even though numbers themselves gave very little indication of the economic reality. However no information is available on the risk-adjusted cost of capital. This lack of information explained partially why CIB, as well as many other Chinese banks, has historically made many economically unjustifiable lending decisions.
CIB’s recent efforts in establishing a firm-wide risk management is an important step in the right direction. Indeed the ultimate goal of the development of internal risk models must be to determine how much capital is actually tied up in a particular industry, transaction, portfolio, and business segment and whether strategic re-direction is necessary at any given point during the risk assessment process. CIB must graduate from a purely “passive” approach, where bank calculates capital requirements but does not link them to performance, compensation or business planning, to a more active approach, where bank starts to use capital requirements in the planning, setting targets or limits for individual businesses. CIB’s senior management expressed hope that as the firm-wide risk models are implemented and more experiences are acquired in interpreting these numbers, CIB will eventually be able to migration to a total active risk management model where strategy and risk are interlinked: bank has clear allocation of capital for individual business, business units’ performance are measured based on this allocation, and future strategy depends on the correlation between performance and capital allocation.
SECTION 5.7 SUMMARY

This chapter examined the operational details of CIB in five core areas:
recapitalization, management and organizational restructuring, management
information system, marketing and distribution, and risk management. The analysis
concludes that CIB is at the important stage of migrating its business model from a
passive approach to an active model where strategy and capital allocation is
dynamically linked and operations are geared towards the successful delivery of
strategy based on risk-adjusted assessment. Based on the observations drawn here,
Chapter 6 attempts to map out a long term development strategy for CIB.
CHAPTER 6 STRATEGY FOR GROWTH

In the new banking environment, many Chinese banks will find that they can not be all things to all people, that they must make choices and be prepared to cede some business to better positioned banks that are simply stronger competitors for particular types of business. The universal bank model of the past twenty years is unlikely to be successful. It is also clear that the balance of power will shift decisively to the consumers in the first decade of the 21st century.

This chapter attempts to develop strategic initiatives which CIB could deploy in the coming banking competition in China. In the corporate banking sector, CIB needs to sharpen its understanding of the margins it is able to generate from different segments of the corporate sector and the real costs of serving those segments in terms of operating costs, risk exposure, and capital requirement. What is more important is that CIB must respond to the changing industry dynamics in the retail sector. The retail industry is likely to generate far more profits on risk-adjusted basis comparing to the corporate sector. However, in the first decade of the 21st century the cost of competing for revenues will increase. Not all banks, certainly not the late comers, will be able to afford the technology and staff training required to develop a credible business in the retail sector. As channels to the customer – through the Internet, ATMs, phone banking, branches and kiosks – proliferate, the costs of leadership will increase. Given the current status of CIB’s retail business, the bank must invest most urgently and aggressively to build a credible and sustainable presence in the retail space.
Regardless of CIB’s strategies in the retail and corporate sectors, the bank will have to manage its balance sheet more aggressively than it had been in the past. The challenge is formidable. However there is clear signal that CIB is taking up these challenges.

On 22nd Sept. 1999, CIB’s parent company, China International Trust and Investment Corp., cleared regulatory hurdles for its acquisition of a stake of about 20 per cent. In the Shenzhen Development Bank “SDB”, China’s only domestically listed bank. This landmark transaction, valued at U$ 200million, was regarded as part of CITIC’s effort to become the mainland’s Citicorp. The move to acquire the SDB stake is a central part of CITIC’s plan to expand its financial services reach. It is understood that the acquisition of the stake could pave the way for a merger or asset swap between SDB and CIB. This transaction represents the clearest sign yet that CIB and CITIC are actively pursuing strategic moves which would enable the transformation of CIB into a powerhouse in Chinese banking industry.
SECTION 6.1 RETAIL BANKING STRATEGY

The key strategic challenge for CIB in the coming decade is its migration from a corporate-centric bank to one which is able to capitalize on the booming consumer market. New customer needs, increasing product complexity and alternative forms of distribution will be the chief drivers of these changes. The opening of China’s underdeveloped and long-protected consumer banking market to foreign competitors will accelerate this transformation.

To prepare for the changing trend in consumer business, CIB need to revamp its external image, internal operating culture, front-line skills, incentive system, and processing capabilities. CIB must make those strategic options which enable itself to take advantage of the growing breath of the domestic retail business, increasing sophistication and differentiation among consumers, easing product restrictions, and emergence of new distribution channels. CIB should support its strategic options with five core skills: product development, marketing, risk management, processing and distribution.

Section 6.1.1 Product Development

Economic development, changing consumer needs, and deregulation in the financial sector will place significant pressure on China’s banks with retail ambition to broaden their product offerings. For example, by 1998, many of the regulatory limits on the categories of products offered by Chinese banks have been relaxed to facilitate the development and distribution of new products. During the same time, PBOC approved
the formation of new asset management companies to market retail mutual funds and began to encourage banks to offer home mortgage loans. The result of these regulatory changes is the creation of retail banking market that increasingly reflect the models found in the U.S. and Europe, where banks sell just about every financial product.

As CIB considers option for broadening its retail product offerings, it is worth keeping in mind how banks in the U.S. have traditionally made money. A 1997 McKinsey study revealed that while 54 per cent. Of total retail balances were held in nontraditional investment products, 85 per cent. Of retail banking profit were derived from core retail deposits and loans. The lesson for CIB, where traditional consumer deposits and loans accounted for the vast majority of its retail balances in 1997, is that while offering new investment products to retain customers and to generate fee incomes will be important, the lion’s share of profits for CIB probably will continue to flow from traditional core banking products. Building the required capabilities for core retail products will be a significant challenge for CIB. It is projected that most of the retail growth is likely to come from new mortgage loans, car loans, and a small amount of personal loans. Making profitable transactions in the new products will not necessarily be easy for CIB, a traditional corporate-centric bank. As the market deregulates and product margin grows thinner, CIB can only sustain and improve its position by offering new products at new service level relentlessly.
Section 6.1.2 Marketing

For much of its history, CIB did not have dedicated retail marketing strategy and infrastructure. The concept of knowing your customers, pursuing customer-oriented solutions and re-engineering customer service delivery was not well developed within CIB. The world’s best performing retail banks, in contrast, see marketing at the very core of its operation and put significant efforts on anticipating, understanding, and realizing customer needs. In order to integrate the marketing efforts with the rest of the retail market development strategy, CIB should invest on developing a comprehensive customer database so that it has the critical capability to anticipate and respond to the changing market conditions in a time efficient manner. Effective marketing can guide CIB to build a sustainable and profitable customer base. For example, an effective marketing database will pinpoint a customer who has moved a large amount of money in or out of her or his account. If this customer is in her or his early 30s, there is a good chance he or she may be preparing to purchase a home. In this case, the bank would then contact the customer to market its mortgage loan and home insurance products. The newly established marketing departments can also combine customer information with external surveys to help segment the customer base, to identify possible promotions to attract new customers, and to test customer satisfaction. On an ongoing basis, marketing operation can profile customer profitability and take actions to lock in profitable customers or cross-sell to loss-making accounts. Building an effective marketing operation will be one of the first steps to transform and set the bank on a retail-driven growth path.
Section 6.1.3 Risk Management

Much has been written on CIB's institutional risk management system in Chapter five. This section elaborates a statically driven credit assessment process that is geared towards developing a deep understanding of retail customers' credit behavior.

Risk management for retail business is a new science for Chinese banks. To handle the large volume of consumer lending applications quickly and cost effectively goes beyond the simply task of process automation. CIB should consider adopt a statistically driven credit assessment approach so that the bank can avoid losses incurred due to poor judgment by individual loan officers. By developing a large pool of credit history, CIB is also able to use the information to price consumer loans correctly. More importantly, the statistical approach can then be applied across the entire CIB franchise to ensure the uniform and consistent execution of the bank's strategy. The highly centralized and automated approach enabled Citibank to reduce its U.S. consumer loan losses by more than 50 per cent. When it was introduced in the late 1970s. Commonly referred to as credit scoring, this approach can be applied across the entire product spectrum from credit cards to the full range of consumer loans. Successful implementation of this statistically driven process is critical to CIB's attempt to build a profitable retail business.

Section 6.1.4 Process Operations

The key to restore the profitability of Chinese banks is to improve the bank's operations. This is true for both corporate banking and retail business. The leading banks in the West have significantly reduced their operating costs by automating and centralizing much of
the paperwork that goes on in the retail banking. Many have removed virtually all back-office processing from branches in order to reduce real estate costs, standardize controls, and gain critical mass in high-volume procedures such as check clearing and remittance handling. To do so, however, the banks have had to make significant investments in process redesign and information technology. Up until now, Chinese banks have by and large ignored the importance of improving and investing in processing excellence in favor of the argument that low labor costs in China is sufficient to mitigate the needs for investment in processing capability. This situation, however, is going to change quickly as the range of products the banks have to offer expands dramatically, and the labor cost continues to climb up as part of the overall operating cost. Excellence in operations will soon be integral to delivering quality and profit to Chinese banks.

Section 6.1.5 Distribution

Distribution will undergo rapid change in China. In order for CIB to succeed in its retail banking strategy, the bank should concentrate on building new product distribution channels to achieve first-to-market delivery advantage. Distribution plays not only an important role in delivery profit-enhancing opportunity but also aligns the whole organization with the overall customer and product strategy. The current mode of single-channel delivery mechanism will give away to a proliferating channels of distribution. As the distribution channels multiply, CIB will then be able to direct its customers to the most cost-efficient option. This will also encourage the sharing of client information across the different product departments within the bank.
SECTION 6.2 CORPORATE BANKING STRATEGY

CIB is currently pursuing important and aggressive organizational redesign. Separating the loan origination and credit approval processes and setting up powerful loan recovery department will generate significant benefits to the bank in the medium term. In the long run, in order to succeed in the corporate business, CIB must recognize the changing dynamics of the business and respond correspondingly. That is, CIB will need to realize that the market is inherently full of risk, and the incursion of foreign banks into the market will only increase risk by removing some of the most attractive credits from bank portfolios. Focusing on markets where a bank can have a credible, sustainable advantage because it has unique insights into credit risk will be critical in the future. “Me-too banking”, based on relationships and crony capitalism, will be increasingly hard to justify. So, too, will plain-vanilla lending to the best credits once competition returns, as it is likely to produce very low returns and destroy shareholder value.

Given this more transparent and competitive world, CIB will have to seek a special customer base or product strength. In its chosen market, the bank must access the best information on the risks it is taking. Superior risk and reward management, based on skillfully accessing and analyzing information about corporate credits, will be a critical element of success for CIB in the future corporate banking business.

As is already true for CIB, in order to compete effectively in the future, credit departments need to be centralized. Independent credit policies and monitoring
procedures need to be set up. Common product and credit processes will be applied to all clients in each business unit, wherever they are served. As far as possible, CIB should try to create centers of excellence in marketing and credit for corporate clients. For large corporations, this may mean organizing coverage by industry group.

CIB will no doubt face more open markets and foreign competition, but also renewed growth and opportunities in corporate banking in the future. The challenge for CIB is to discipline its long term corporate business for the long term, and to align its organization to produce long-term profits. Because corporate banking cover so many customer and product segments, coupled with CIB’s historical success in this market, there is plenty of room for CIB to find unique, defensible franchise or position in the market and to prosper.
SECTION 6.3 ASSET MANAGEMENT STRATEGY

In addition to the tremendous opportunity in the retail consumer market and challenges in the corporate banking sector, asset management presents Chinese banks with another important potential revenue channel. Opportunities in this area will come from two businesses: retail and institutional. Retail asset management encompasses selling mutual funds and unit funds to individual investors, while institutional asset management entails managing money for pension funds, life insurers, corporations, and possibly government agencies.

Retail asset management in China will mirror the business elsewhere in the world, that is, a professional manages individual’s investments. With the introduction of the first mutual fund product in 1998 in China, the market for retail asset management has grown rapidly to catch attention from most of the domestic financial institutions. Institutional asset management caters primarily to government pension funds, private pension funds, insurance companies, banks, and corporations. In contrast to the retail asset management business in China, institutional asset management is yet to be developed.

Section 6.3.1 The Retail Market

At this stage, China’s retail asset management market is small and unpredictable. Any decision by CIB to build institutional capabilities requires a fundamental belief in China’s long term growth prospect as well as the continued rise in living standard.
With very few securities available and tight regulation, the mutual fund and asset management industry in China was still nascent at the end of the 1990s. By mid-1998, there were only US$1.2 billion in mutual fund assets in China, representing about 0.2 percent of total personal savings, compared with 15-20 percent in the developed economies and 2-13 in the rest of Asia. But concerns about speculation and a lack of professional approach in the equity markets encouraged the government to begin experimenting with mutual fund products that will provide diversification and professional advice to investors. Assuming that, by 2010, China would have reached up to 25 per cent. Of the developed world’s mutual fund penetration level, total mutual fund assets in China will range between US$55 billion and US$90 billion.

The government’s main concern regarding the development of this market is how mutual funds will affect the flow of deposits to banks and ultimately to corporations. While mutual funds can more efficiently channel the nation’s savings directly into the capital markets, they will also take away deposits from the banks, over which the government has more direct control. Even if the government decides to let the market develop freely, many obstacles remain. Distribution, despite large existing bank networks, will prove difficult because of conflicts with the banks’ desire to collect deposits and the lack of trained personnel to educate customers about mutual fund products. Partly to get around the problem of distribution, most of the mutual funds in China by the end of 1990s were closed-end funds traded on stock exchanges, a product relatively uncommon in the developed markets.
CIB however is in a unique position to explore opportunities in the retail asset management market. Its parent company CITIC has clearly stated ambition to become the CITI Group of China and has every intention to develop its financial capabilities in most product categories. CITIC also has specific agenda for integrating CIB with that of its securities arm, CITIC Securities. Being able to cross-sell and distribute products on an integrated platform is central to CITIC’s overall development strategy. CIB should capitalize the group’s strategic goal by gradually introducing retail asset management product through its branch network, possibly in co-operation with CITIC Securities.

Section 6.3.2 The Institutional Market

China’s large and aging population is going to generate a large sum of institutional assets. However, China lags behind its Asian neighbors in developing a pension scheme. Assuming that it will adopt a scheme by 2005 at a contribution of 10 per cent. Of gross income, China’s pension assets will reach US$840 billion by 2010, making it Asia’s third-largest market after Japan and Singapore. Who will ultimately manage these huge assets depends on how government regulation evolves. The government will need to decide who will manage the nation’s savings, as well as how assets will be allocated. If the government emulates its Asian neighbors, private managers will have no roles: at the end of the 1990s, government bodies managed nearly all-public pension funds across Asia outside Japan. However given CITIC’s unique position in the development of China’s financial market, it is possible that CIB will have the opportunity to participate early in the formation of the institutional asset management market.
CHAPTER 7 CONCLUSION

Important progress was made since Asia financial crisis in reforming China’s state-owned banks. CIB is an example of Chinese banks taking decisive steps to address their respective problems. From research conducted on CIB, this thesis concludes that banking reform in China can not rely solely on macroeconomics measures such as one-off capital injection to repair Chinese banks’ balance sheet. A great deal can be achieved through incremental improvements in banks’ operation. At the same time, improvements in operation is also the ultimate guarantee for the long term sustainability of success in reforming Chinese banks. This thesis, using CIB as a case in point, points to

- recapitalization through incremental profit enhancement;
- management and organizational restructuring;
- implementation of management information system;
- development of marketing and distribution capabilities; and
- establishment of risk management system

as the five effective mechanism to achieve results at individual bank level. This thesis also attempts to map out the strategic development plan for CIB and argues that CIB should reorganize its internal resources to

- make the transition to a consumer-centric banking model; and
- re-evaluate and re-position its corporate banking business, taking into account the inherent and continually rising risk profile in the business.
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