

# Chinese Bankers Survey 2009

## Executive Summary

September 2009





# Introduction

Welcome to the first joint PricewaterhouseCoopers (PwC) and China Banking Association (CBA) survey of Chinese bankers, led by Dr. Ba Shusong from the Development Research Centre of the State Council of China.

The key objectives of the survey are to:

- Understand the bankers' view of opportunities and challenges facing China's banking industry in the current financial crisis;
- Provide a platform to discuss insights from bankers on China's banking reform, development and banking supervision; and
- Promote mutual understanding and communication between the regulatory authorities, domestic and international markets and the Chinese banking industry.

The survey was conducted among banking institutions across the country, including head offices, provincial and regional branches. The results of the survey are based on interviews with 81 senior bank executives and 732 completed questionnaires.

This executive summary sets out the key findings from our survey. The full commentary and analysis of the survey are published in Chinese in the publication 中国银行业调查报告2009 (Chinese Bankers Survey 2009).

Through this survey, we believe that readers can obtain a comprehensive insight of the professional opinion of leading bank executives in China. This survey also complements the established PwC survey "Foreign banks in China", last published in June 2009.

Findings of particular interest include observations on:

- The impact of the financial crisis;
- The impact of economic policy;
- The standard of corporate governance;
- The rapid growth in loans;
- The development of SME lending and rural banking;
- The level of financial innovation and comprehensive service offerings;
- Risk management;
- Banking processes and information technology;
- Human resource incentive and development system;
- The approach to globalisation and strategic investors; and
- The role of regulators.

We trust that bankers and other readers will find the information in this comprehensive survey useful.

We would like to thank the chairmen, chief executive officers and senior bankers who participated in this survey for their time and effort in making this publication possible.

The survey will be conducted on a regular basis to continue to promote an understanding and analysis of trends in China's banking sector. We look forward to receiving feedback on this survey and on topics to be included in future surveys on the China banking industry.

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# Participating Banks

This survey focuses on the views of Chinese bankers regarding the Chinese banking industry and its development. The survey attempts to synthesise diverse viewpoints, protect confidentiality and offer insights on the Chinese banking industry. It is based on interviews with 81 senior executives and 732 questionnaires received from a wide range of banks in China.

The participant banks were:

## 1. Large size state-owned banks (6)

- Industrial and Commercial Bank of China
- Agricultural Bank of China
- Bank of China
- China Construction Bank
- Bank of Communications
- Postal Savings Bank of China

## 2. Joint stock banks (12)

- China Bohai Bank
- Guangdong Development Bank
- Huaxia Bank
- Evergrowing Bank
- Shenzhen Development Bank
- Shanghai Pudong Development Bank
- Industrial Bank Co., Ltd.
- China Merchants Bank
- China Zheshang Bank Co., Ltd.
- China CITIC Bank
- China Everbright Bank
- China Minsheng Banking Corp., Ltd.

## 3. Policy banks (3)

- China Development Bank
- Agricultural Development Bank of China
- The Export-Import Bank of China

## 4. City commercial banks (urban credit cooperatives) (20)

- Baoshang Bank
- Baoding Commercial Bank
- Bank of Beijing
- Bank of Changsha
- Bank of Chengdu
- Bank of Dongguan
- Handan Commercial Bank
- Hankou Bank
- Bank of Hangzhou
- Huishang Bank
- Bank of Langfang
- Bank of Nanjing
- Pingan Bank
- Bank of Shanghai
- Shijiazhuang City Commercial Bank
- Bank of Tianjin
- Xi'an City Commercial Bank
- Guangzhou Commercial Bank
- Zhengzhou Commercial Bank
- Zhangjiakou City Commercial Bank

## 5. Rural commercial banks and rural credit cooperatives (15)

- Rural Credit Cooperative of Anhui
- Beijing Rural Commercial Bank
- Rural Credit Cooperative of Fujian
- Rural Credit Cooperative of Guangdong
- Rural Credit Cooperative of Guangxi
- Rural Credit Cooperative of Guizhou
- Rural Credit Cooperative of Helongjiang
- Rural Credit Cooperative of Hubei
- Rural Credit Cooperative of Hunan
- Yellow River Rural Commercial Bank
- Rural Credit Cooperative of Jiangxi
- Rural Credit Cooperative of Qinghai
- Rural Credit Cooperative of Shandong
- Rural Credit Cooperative of Shanxi
- Rural Credit Cooperative of Xinjiang

## 6. Joint venture banks (2)

- OCBC Bank (China) Limited
- Xiamen International Bank

# Executive Summary

## The impact of the financial crisis

Chinese bankers have an objective and rational approach to the performance of the Chinese banking industry during the financial crisis. The Chinese banking industry maintained overall stability throughout the crisis, a fact which the bankers attribute to the prudential regulatory system. In addition, bankers comment that the Chinese banking industry has been protected by its relatively limited degree of globalisation and by the effectiveness of strong macro-economic stimulation measures implemented by the Chinese government. In particular, the introduction of strategic investors, restructuring of joint stock banks and stock exchange listings increased the overall competency of the Chinese banking industry during China joined the WTO.

The bankers acknowledge that there remains a huge gap between Chinese banks and international players and believe that the global financial crisis was a rare chance for the Chinese banking industry to learn and improve. At the same time, they express confidence that the Chinese banking industry does have its own advantages and that these should be objectively acknowledged and studied. The bankers highlight that in studying the international banks, they have tried to remain both objective and fair-minded.

The bankers believe that the crisis has not resulted in changes to the social development drivers which sustain the long-term development of the Chinese banking industry. They believe that an increase in awareness of wealth management among the general population, the increased demand for financial services, the changing structure of wealth and the general acceleration of urbanisation in China, among other developments, will create new opportunities for growth in the banking sector.

## The impact of macro-economic policy

The bankers noted that the shifts in macro-economic policy made by the Chinese government in 2008 created significant challenges to their banking operations, resulting in tremendous pressure being placed on senior executives who, for the first time since the stock system reforms and stock exchange listings, faced large-scale fluctuations in the economic cycle.

They give high overall ratings to the policy package the Chinese government has adopted in responding to the financial crisis, and believe that the fiscal policies are most notable for being forward-looking. The currency policies are most notable for their strength and rationality but are relatively weak with regard to forward-looking elements, with the industry policies scoring lowest in terms of rationality.

They are highly concerned about industrial transformation under the industry policies. They believe that the ten “Industrial Adjustment and Revitalisation Plans” serve as a guideline for the flow of bank loans, but also increase risks to banks. The reduction of loans to outdated industries may result in the deterioration in the quality of loans, while the concentration of bank loans to those industries targeted by the government may also create new areas of excess capacity.

The freeing up of interest rate controls in the market is the one policy that attracts the greatest concern from bankers, who believe that a completely market-driven approach to interest rate will lead to polarisation of the competitive landscape within the banking sector and lead to acute competitive pressure for some medium and small-sized banks.

## Corporate governance

According to the bankers, the evolution and transformation of corporate governance in the Chinese banking sector from one of form to one of real substance will be tough, especially given the evident gap between the current situation and the best practice. Nearly 40% of respondents believe that the roles and responsibilities of shareholders at shareholder general meetings, the board of directors, the supervisory board and management are not sufficiently clear.

Incentive systems provided by boards of directors to senior management are still in the early stages of development, and half of the bankers consider the available incentive system inadequate. Currently, incentive measures mainly take the form of short-term remuneration incentives (representing 77.5% of surveyed banks), and only a small number of banks provide long-term incentives to their management, such as stock ownership, stock options or stock value appreciation rights.

The respondents differ in their opinion of the salary cap issued by the Ministry of Finance. Some believe that as banking is a protected sector, compensation within banks must be reflective of the overall conditions of the economy and society and must therefore be consistent with the general levels of compensation across the social strata. Others point out that remuneration mechanisms, as a key component of corporate governance, should follow proper corporate governance procedures within an enterprise.

## Accelerated placement of loans

The economic stimulation package adopted by the Chinese government at the end of 2008 has received strong support from the banking sector in China. Over 80% of the bankers consider it an essential component of their social responsibilities to “actively contribute to the realisation of the state’s development strategies” and “actively support the implementation of the fiscal and financial policies.” 70% of the respondents predict that the size of new loans in 2009 will exceed that of 2008 by more than 20% (note: this has already been achieved by the banks in the first half of 2009).

The bankers note that intensive competition as a result of accelerated lending has further weakened the banks’ position when negotiating price.

According to the bankers, they are focusing on loans to infrastructure projects. New energy and agriculture projects are also attracting serious attention from the banks.

66% of the respondents indicate that consumer housing loans are the most important product in the development of personal finance business in China. However, this attitude is overlaid with a certain level of caution with regard to real estate development loans, with 79% of bankers stating that they would focus on ensuring loans were supporting sound development projects.

With respect to the selection of commercial customers, the primary factor the bankers

examine in originating a loan is the sustainable profitability of an enterprise. The bankers are also highly concerned about the following key features of an enterprise: whether the enterprise is environmentally-friendly, whether it operates a high energy-consuming business, whether it is a high-polluting or resource-intensive industry, and whether it has an adequate corporate governance structure.

The bankers believe the rapid growth in lending will bring changes to the banking competition landscape. As a result of intensified lending activities, large and resource-rich state-owned commercial banks have consolidated their market shares, while small banks are not so favorably positioned to take advantage of the policies, as they are not able to participate in some large-scale projects due to their limited funding sources and regulatory restrictions over loan concentration.

However, this situation has also forced the banking industry to accelerate changes to their market strategies and increase the level of differentiation and competition in order to minimise homogenisation across the industry. Some medium-sized banks have begun to reduce their dependence on large clients and focus on the potential of middle-market customers, including a focus on regional rather than national leading enterprises and non-key industries. Medium sized banks have also begun to engage in more innovative business activities. Small banks demonstrated a clear understanding of the market reality and declared that they shall focus on lending to medium and small-sized enterprises.

## SMEs and rural banking

80% of the bankers believe that SMEs are critical for the future of banking business development, ranking top on their corporate banking agenda. This attitude indicates that SMEs are an unprecedented priority as shaped by both the government policies and the banks' own growth needs.

The attitude toward SME business varies by type of bank. Joint stock banks operating on a national basis restrict their focus only to SMEs in developed regions and maintain a cautious stance with regard to other regions. The city commercial banks are the major players in the SME sector, with an expectation of stronger government policy support.

There is also a notable difference of intentions between banks with respect to their involvement in rural banking. Policy banks and state-owned commercial banks are enthusiastic about the area. However, joint stock commercial banks regard it as a lower priority; 49% of their senior executives, the highest of the survey, indicated that they were not ready nor had the plan to expand into this area; and only 20% of senior executives, the lowest of the survey on this topic, expressed a strong commitment to this business sector.

## Financial innovation and comprehensive financial services

These are the two areas that have generated extensive debate as a result of the financial crisis.

85% of the bankers believe that banking innovations should receive continued encouragement and support provided that the risks are well under control, whereas only 2% of the respondents are of the opinion that financial innovation should be suspended.

The bankers identify deposit and loan-related products as the areas most in need of financial innovation. 70% of the bankers select new lending businesses, such as syndication and M&A, as the area in greatest need of innovation, with consumer lending trailing in second place.

85% of the respondents see the more rigorous regulation over financial derivatives and other innovative activities as having the biggest impact on the Chinese banking industry as a result of the financial crisis.

With respect to comprehensive financial services, 46% of the respondents think that the Chinese banking sector should continue in the direction of providing a comprehensive set of financial services and should not change course as a result of the financial crisis, whereas 15% believe the right move is to slow the pace of change in this area.

However, when asked about the preferred model for providing comprehensive financial services, 58% of the bankers pick the model with separate legal companies under a financial holding company as the ideal structure, whereas 35% choose the structure with a bank offering all services.

## Risk management

55% of the bankers predict a significant increase in non-performing loans in the future. However, 80% of them are confident enough to indicate that they expect to maintain their own NPL ratio at less than 5% for the next three years. They point out that rapid growth in lending may give rise to imprudent or less rigorous lending practices among banks, and that industry and regional concentration risks and risks associated with the financing platforms of local governments are all areas which will require serious attention.

The survey results indicate that the Chinese banking sector faces unprecedented pressure with regard to credit risk management, and that the pressure on operational risk management is also increasing. The bankers' awareness of risk management has increased substantially, enabling them to pursue the optimal balance between business development and control of risk.

The level and competency of risk management differs significantly from one type of bank to another. Listed banks are evidently more confident in their risk management capability than non-listed banks, a result of the Chinese banking reforms.

The Chinese bankers are busy preparing for the implementation of the New Basel Capital Accord. Key tasks engaging their attention include the establishment of risk management rules and procedures, building of internal rating systems, data capturing and model building.

To the bankers, the biggest difficulty in implementing the New Basel Capital Accord is implementation of the risk policies and procedures, whilst the lack of underlying data is also causing headaches.

## Banking process and Information Technology (IT)

Domestic banks in the Chinese banking sector are restructuring their businesses in response to changes in banking competition, the banking environment and client needs. In particular, they are promoting a structure of strategic business units (SBUs). The operational integration of business units and the level of resistance from branches are perceived as the biggest issues in this process.

The bankers believe that SBU reform can help improve both specialisation and standardisation of banking services, but point out that the SBU implementation projects are in the development stages and are affected by overly long management chains and the considerable difficulties integrating huge numbers of silo-structures and resources.

Most Chinese banks have drawn up their own IT blueprints and strategies, an undertaking that has not been hindered at all by the financial crisis.

64% of the bankers respond that the IT commitments of their banks have not changed or have changed only slightly due to the financial crisis, whereas 35% of the respondents declare that driven by the crisis, their banks will increase investment in IT initiatives to accelerate the pace of transformation. Data warehousing, among other technologies, is believed to play an important role in the banks' future operations and is of great priority to the bankers.

## Human resources

The general response from the bankers is that they will continue to recruit people in the future, with 37% anticipating an increase of more than 10% to their workforce. Compared to management of the head offices and provincial branches, senior executives of tier-three branches have expectations of a greater increase in headcount, partly as a result of the regulators' relaxation of market-entry policies regarding restrictions on branches of medium and small-sized banks.

Regarding improvement of human resources management, the bankers believe performance measurement and training are the areas that demand urgent reform action, reflecting the need for incentive mechanisms and high-quality human resources in commercial banking for effective structural transformation.

## The process of globalisation

The financial crisis has not affected the resolve and commitment of the Chinese banking sector to achieve globalisation, but has made Chinese bankers more cautious. Only 17% of the respondents expect a decrease of M&A activities. However, 45% of the respondents believe it is difficult to judge the true extent of losses of overseas banks during the crisis, and that caution should be exercised. Those who believe the opportunity now exists to enter at the bottom of the market represent only 8%.

Close to 70% of the respondents consider a lack of accurate and detailed understanding of the overseas environment, practices and policies and the limited capabilities of the Chinese banks in areas of management and control as the biggest obstacles to going global. The results of the survey among state-owned commercial banks

which have considerable experience overseas show that the major obstacle to going global to be the limited ability of the Chinese banks in areas of management and control.

The bankers warn that in carrying out cross-border M&A, Chinese banks should pay attention to the integration of resources, particularly synergies of integration after the M&A transaction, rather than focusing on a simple expansion of business size.

## Strategic investors

The Chinese bankers agree that international strategic investors have played an active role in promoting the competitiveness of Chinese banks, as shown through the advances in management competency, improvement of corporate governance structures, better product innovation capability and the introduction of new technologies.

Regarding the withdrawal of investments by overseas strategic investors, more than 70% of the respondents believe such action was a move to alleviate the overseas investors' own financial plight and did not reflect a pessimistic attitude towards the growth potential of the Chinese banking sector.

Among banks which have yet to introduce strategic investors, 54% have plans to do so, including a notably high percentage of banks in the Yangtze Delta region compared to other regions. However, the preference for strategic investors tends to diversify, as senior executives of city commercial banks indicate they would consider domestic leading joint stock banks and

city commercial banks as their primary targets rather than international strategic investors.

84% of the respondents believe that foreign banks are yet to present strong competition to the domestic banks in China other than in certain niche areas.

## On regulatory framework and operation

The bankers commend the work of China Banking Regulatory Commission (CBRC), with 96% of the respondents considering its regulatory concepts and methods "highly sound and effective" or "sound and effective". The on-going regulation approach has received positive feedback from an overwhelming majority of the respondents. The macro prudential regulatory approach centered on serving the real economy is perceived by the bankers as a critical measure to address the financial crisis.

The bankers think highly of the effectiveness, specialisation and independence of the work of regulators, but give low scores on the interaction of regulators with banks and markets. They highlight a need to further improve work style and the quality of regulatory personnel at local level.

They have raised other recommendations including that regulation should continue to encourage and guide financial innovation, regulation should be more forward-looking, regulation should differentiate between banks of different sizes, and inter-departmental coordination and cooperation should be enhanced.

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