

Bank Reform in China

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Since the late 1980s China has begun to reform her banking system. A great number of steps have been taken. Banks are no longer an official sector but profitable business organizations. Bank business and interest rates are gradually liberalized. Government intervention in the banking system is reduced. Regulation on banks is greatly improved to urge the banks to do business according to the international norms. State owned banks raised capital by huge government injection and issuance of bonds to meet the capital requirement of the international community. The volume of non-performing loans is dramatically reduced by the write-off, sale-out and severe credit risk management. Bank management is also improved by the introduction of western style corporate governance. The earning ability of the banks is strengthened remarkably. Significant achievements in such short time have implied that the bank reform is highly successful. Great improvement takes place over a short period and we are beginning to see real commitment to improved practices at one bank after another.

However, the relict of somewhat weak governance, poor management, lack of innovation and outmoded technology continue to hinder China's commercial banks. The earning ability of Chinese banks is still low as indicated by low ROA and ROE by international standards. The banking system in rural areas is even worse.

The top bank managers are still appointed by the government and seem to serve a government function as well as acting as the chairman of the board of directors. On one hand it seems that they have unlimited power and are often placed at institutions without a process of consultation with the board of directors and therefore may not become sensitive to the full range of shareholder issues. They will better understand all shareholders goals if they take part in a bona fide selection process. On the other hand those top managers have only limited decision-making power for they have no independence from the the government. In this regard the SOCBs are not fully market-oriented yet and generally lack an effective incentive mechanism. No bank officials will abdicate power without external pressure, which has prolonged the reform of China's banks.

The history of market-oriented banks and the related reforms in China is no more than 20 years. The Chinese bank industry is still an infant industry. But Chinese banks on the whole already possess preliminary international competitiveness. Full openness to foreign banks after 2006 will not lead to the collapse of domestic banks. Increased competition between the domestic banks and foreign banks will help provide stimulus for the former to improve their management still further.

Chinese banks have already established a framework similar to foreign banks. However it is not easy to learn the way of thinking and the culture from foreign banks. Achieving sustainable performance will depend on meaningful structural overhauls and the

emergence of a credit culture, both of which are longer-term propositions. Bank reform is far from finished. Bold and fast steps, for example further privatization, are needed to improve corporate governance and to reduce government control in the banking system.

It is almost certain that Chinese banks will make continuous progress over time along with the further reform although it is surely a long journey.