# Event Report

# Insights into China's Banking Industry: Ma Weihua at the Inaugural China Business Initiative Forum

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*On October 26th, the China Business Initiative at Columbia Business School marked the launch of its inaugural forum. The forum featured Ma Weihua, President and CEO of China Merchants Bank, who shared first-hand insights on the globalization of the Chinese banking sector. The China Business Initiative, organized by the Jerome A. Chazen Institute of International Business and directed by Fangruo Chen, the Ira Rennert Professor of Business, provides a platform for representatives from academia, industry and government to exchange ideas and generate research on management and economic issues facing China.*

Dr. Ma attests that the type of financial crisis we face today comes once every 100 years, and the effects on the global banking industry have been far-reaching. Banks within developed countries will record a total asset write-down of USD 2.8 trillion by 2010. Global profits in 2008 alone plummeted by 15 percent year over year, while return on net assets declined by 5 percent year over year. The Chinese banking industry, however, has maintained solid performance amidst challenging market conditions. Dr. Ma attributes such performance to concerted efforts to improve banking industry fundamentals through regulatory reforms. Effectively managing innovation and growth will be crucial for the success of this industry to endure going forward.

The Chinese banking sector has performed remarkably well: In 2008, Chinese banks increased profitability by 30 percent year over year. During the first half of 2009, the total profits of the 14 listed Chinese banks reached RMB 230 billion, a slight decrease of 3 percent year over year, with seven banks reporting positive growth. Moreover, credit supply for the first nine months of 2009 totaled RMB 8.7 trillion, higher than in previous years. These banks have bolstered asset quality, as the ratio of nonperforming loans (NPL) to aggregate loan portfolios has declined to 1.8 percent as of June 2009, a decrease of 65 basis points versus the beginning of 2009 and a decrease of 380 basis points versus one year prior. The market has recognized this industry’s success, as 52 Chinese banks rank in the list of Global Top 1000 Banks published by the U.K. magazine *The Banker*. Thus, ample scale and asset quality largely insulated the Chinese banking industry from the severe impacts of the current crisis.

The strength of China’s banking sector was enhanced during the past 30 years of economic and financial reforms. The country’s asset scale grew to over RMB 73 trillion from less than RMB 200 billion in 1978, representing a compound annual growth rate exceeding 20 percent. Additionally, the overall NPL ratio declined to below 2 percent from highs of 20 percent, and the NPL coverage ratio increased to over 130 percent from lows of 20 percent. Today, over 200 banks, representing 99.9 percent of the country’s total banking sector assets, have fulfilled the minimum capital requirement.

Dr. Ma compares the current industry dynamic to a marathon race: Those runners that once led the pack have fallen down, and the Chinese banking industry has an opportunity to sprint to the front. One of those potential sprinters is Dr. Ma’s own China Merchants Bank (CMB). CMB began 20 years ago with RMB 100 million in capital and a single office of 36 people. Today, CMB is a national commercial bank listed on both the Shanghai and Hong Kong stock exchanges. CMB has net capital exceeding RMB 100 billion and total assets approaching RMB 2 trillion, with a network of 700 outlets and employee headcount of 37,000. During the five years from 2003 to 2008, CMB recorded a compound annual growth rate of 58 percent in net profit and a return on net assets of 20 percent while markedly reducing its NPL ratio and increasing its NPL coverage. Accordingly, CMB was awarded numerous top industry honors from authoritative media such as *Euromoney*, *Investor Relations* and the *Wall Street Journal*.

CMB depends on innovation to drive performance. In 1995, CMB was the first Chinese bank to launch the “All-in-one Card,” a multifunctional debit card that allowed an account to have a variety of deposits in different terms and currencies all integrated together. This card has become one of the most preferred bank cards in China. Thus far, 50 million All-in-one Cards have been issued, with an average deposit balance of RMB 8,500, far exceeding the national average.

China was also able to avoid the harsh effects of the current crisis through continuous improvement of its financial regulatory system. Such improvement was one of the key factors driving the approval of CMB’s New York branch. Since its inception in 2003, the China Banking

Regulatory Commission has continued to implement its philosophy of supervising legal persons, managing risk, monitoring internal control and increasing transparency. In abiding by the New Basel Capital Accord, China accelerated its process of implementing regulatory reforms.

The relatively small participation of Chinese banks in the international market undoubtedly softened the blow of the financial crisis. However, there remains a pressing need for Chinese banks to sharpen their international competitive edge going forward. As of June 2009, there were 32 foreign and joint venture banks incorporated in China. Moreover, 73 foreign banks from 25 countries and regions have set up 106 branches in China. The Chinese banking industry has already made its own strides in going global. Seven Chinese banks have already taken stakes in 12 foreign financial institutions. These banks have established over 1,000 branches and offices in nearly 30 countries and regions. In 2008, CMB took a significant step in globalizing its operations by establishing its New York branch. CMB also acquired Wing Lung Bank in Hong Kong, granting CMB access to a global marketplace.

The deleveraging and effective retrenchment of American and European banks offers rare opportunities for Chinese banks to increase their global capabilities. Success in the Chinese banking industry hinges on further growing their businesses organically or through merger and acquisition activity, attracting management talent and maintaining a focus on the local market. Chinese banks must consider three questions when contemplating overseas expansion: (1) Does management have the capability to effectively control the target enterprise? (2) Do synergies exist such that one plus one is bigger than two? (3) Is the timing right such that value exceeds risk? Despite recent successes, Chinese banks must continue to play catch-up with the rest of the global industry in managing innovation, operations, compliance and risk. In international expansion, Chinese banks must also recruit local talent with a keen knowledge of the local culture, market and regulatory environment.

In addition to successfully deploying globalization strategies, Dr. Ma professes that the strength of Chinese banks will be largely driven by the prosperity of the Chinese market. In pointing to a recent *Forbes* article that classified 400,000 Chinese households as "rich" and projected that figure to double in the coming years, Dr. Ma remains optimistic for China and its banking industry.

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