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Research Report



2016 Report on Chinese Banks' Internationalization Press Release

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Press Release

2016

Report on Chinese Banks' Internationalization

——benchmarking global leaders

Academy of Internet Finance (AIF), Zhejiang University,

in partnership with

China International Finance Society &

PricewaterhouseCoopers &

International Monetary Institute (IMI), Renmin University of China

are pleased to release the progress report of a research project on Chinese banks' global expansion with the key findings and recommendations summarized below.

During 2015, with the complexity of international economy kept growing, the significance of new normal state of Chinese economy increasing, the achievement of RMB internationalization and the strategy of “the Belt and Road Initiatives” deepening, Chinese banks' footprints in internationalization continued to expand. Chinese bank's influence on international market is enhanced with their growing business presence and maturing branch network in foreign countries. However, the gap between Chinese banks and global top banks remains on business scale and exploitation degree of new markets. In the context of increasingly complex and diversified economic environment, Chinese banks must be fully aware of their own situation, actively seize market opportunities, constantly learn from their own experience during internationalization, reasonably plan their blueprints on overseas

expansion and enhance their development strategies.

From CBII to BII

As Chinese economy has entered a new normal state of “implementing a more proactive and opening strategy” and RMB was added to SDR, our *2016Report on Chinese Banks' Internationalization* introduced Chinese Bank Internationalization Index (“CBII”). We expanded our Bank Internationalization Index (BII) by choosing two group of data including bank’s number of overseas branches, overseas assets and revenue and etc. In addition to analyze top-tier Chinese banks’ activeness in internationalization, 16 of the Global Systemically Important Banks (G-SIBs) were selected as benchmarks. So, in this report, we not only summarized Chinese banks’ achievements in global markets but also compared the differences between Chinese and foreign. We also explored the future roadmap of internationalization and risks during the process, in order to provide a good reference for Chinese banks.

Ranking &Major Findings

- ◆ **Growth rate of Chinese banks’ BII declined and the gaps between Chinese Big 5 and listed banks narrowed.** On one hand, the consolidated BII of Chinese Big 5 Banks was 8.90 in 2015 with a growth rate of 4.1% compared to 8.54 in 2014. However, this growth rate in 2015 is still lower than their growth rate in 2014 (12.0%). Among them, Bank of China still achieved the highest BII as 21.57, then successively followed by Industrial and Commercial Bank of China Limited (8.94), Bank of Communications (7.15), China Construction Bank (4.33) and Agricultural Bank of China (3.41). On the other hand, the consolidated BII of five listed banks was only 2.7 with growth rate as 10.1% in 2015, which was much compared to the growth rate in 2014 (20.7%). China Everbright Bank and Shanghai Pudong Development Bank ranked 20 and 22 with their BIIs as 4.36 and 3.66 respectively, which is closely followed by China Construction Bank (ranked 21) and Agricultural Bank of China (ranked 23).
- ◆ **Chinese banks’ global network has covered most countries but with focus on**

“the Belt and Road Initiatives”. Chinese banks continued to follow their strategies as “from near to far; from the developed countries to developing countries” when expanding their global networks in overseas countries. Big 5 Banks have established branches in nearly 50 major countries and the proportion of Asia branches accounted for 44.4%. And “the Belt and Road” countries became their first-priority target for overseas investment. In 2015, Bank of China set up five branches in Southeast Asia along the Silk Road and successfully issued the world’s first “Belt and Road” bond of \$4 billion. China Construction Bank also established five new branches in Europe each located in UK, France, Spain, Italy and Netherlands.

- ◆ **Chinese bank’s international influence is well recognized but still behind foreign banks.** In 2015, China had four banks qualified as G-SIBS, which are Industrial and Commercial Bank of China Limited, Agricultural Bank of China, Bank of Communications and China Construction Bank. We have the same number of G-SIBs banks as France and UK (13% of the whole list), however, we’re still behind US who has 8 G-SIBs banks in total. In our BII system, the average BII of 16 foreign banks was 53.65, which is six times higher than consolidated BII of Chinese Big 5 banks and 19.9 times higher than consolidated BII of Chinese listed banks. Bank of China, the bank with the highest BII in China, only ranked 16th among the 26 banks and its BII was only 1/4 of Standard Chartered Bank (88.84) who ranked first. The breadth and depth of Chinese banks’ business activities in overseas markets is still not competitive compared to foreign banks. In 2015, the number of countries where HSBC’s branches are operating is 2.4 times higher than Chinese Big 5 Banks combined. Also, the contribution from their overseas branches to the whole HSBC group is 43.7 times higher. However, among all operational indicators, the gap between Chinese and foreign banks in overseas loans is narrowing. This implies that Chinese banks are still focus on traditional deposit and loan business in their overseas activities. Their current profit model centering on interest income must be changed.

- ◆ **Chinese banks' total overseas assets kept growing while foreign banks were already at mature stage.** By the end of 2015, the total amount of Chinese Big 5 Banks' overseas assets amounted to 9.87 trillion RMB with a significant growth rate of 14.2%. Their overseas assets accounted for 11.8% of their total assets and remain same as 2014. In contrast, signs of foreign banks have reached the mature stage for their globalization are prominent. Although the growth rate of foreign assets, deposits, loans and employment for selected 16 foreign banks was near to zero and even with a slight shrinkage in 2015, their business scale in domestic and overseas markets are almost same. 3/5 among top 5 banks in each BII index are foreign banks.
- ◆ **Chinese banks' overseas business has yielded promising outcomes, but there still lied a long road ahead.** In 2015, total amount of China Big 5 Bank' overseas revenue topped 200 billion RMB yuan with overseas profit exceeded 100 billion RMB yuan for the first time, which was up to 17.0% and 6.7% respectively compared to 2014. However, except for the Bank of China, the overseas operating revenue and profits of Chinese banks only accounted for less than 10% in general, significantly dropped behind foreign banks. In 2015, the average overseas operating revenue to the total operating revenue ratio for Big 5 banks (8.0%) was 1/7 of the average level of selected foreign banks(59.4%); the average overseas profits to the total profits ratio for Big 5 Banks (8.3%) was only 1/8 of the average level of foreign banks(68.7%). We can see there still lies a long way ahead for Chinese banks to continuously develop their overseas business in the future.
- ◆ **The country size and its economies of scale, internationalization of its currency, its positioning of banking business and etc. has affected Chinese banks' progression of internationalization.** Based on our analysis of cases on banks' internationalization, we noticed that factors like smaller country size, greater economies of scale, more advanced economy, higher internationalization level of economy, currency and enterprises will benefit banks in that country for their business internationalization. Universal banks and wholesale banks from

these countries in these countries was more active in foreign countries compared to retail banks. Nevertheless, the model of banks' internationalization required banks to be equipped with multiple features, which made it more difficult for other banks to replicate. Thus, most banks are more inclined to adopt traditional internationalization mode for their overseas business development.

- ◆ **Risk incidents continuously emerged, robust risk management is critical for banks' success in internalization.** It was frequently reported in the media that financial institutions suffered great loss, lawsuit or penalties due to various types of risks incidents. According to statistics, from 2008 to 2014, number of lawsuit cases against JPMorgan chase, Citigroup, Goldman Sachs, Bank of America, and Wells Fargo reached to 150 and \$95 billion in economic loss. Chinese banks were more exposed to potential risks during their international expansion, due to their lack of operational experience and resources in foreign countries. Since 2000, Chinese banks had more than 10 risk incidents, mainly caused by their reckless business expansion, lack of risk control and limited legal knowledge. Therefore, Chinese banks shall attach greater importance to risk prevention and control in their international operation as well as actively learn experience from foreign banks.

Suggestions for Chinese banks' Overseas Development Strategy

In the upcoming future, the world's economic situation remains challenging. The US election and the Federal Reserve' raising interest rate has brought uncertainties to the US economic recovery. Britain's exit from the EU made Europe economic prospects unclear. Emerging markets has become volatile with complexity of various risks. Among all, Chinese economy remains in the "new normal" state with the supply-side structural reform at its core.

In such context, Chinese banks shall be aware of their significant disparity with the world's international banks at the forefront. Chinese banks shall analyze both domestic and foreign environment, seize political development opportunities, adopt

new means of development, and adjust the pace of their overseas development in order to achieve sustainable global expansion. When selecting a country or region to go abroad, Chinese banks should choose to strengthen their cooperation with countries along “the belt and road”. In Southeast Asia, focus shall be put on the support of import and export trading projects. The cooperation mechanism with Mongolia, Russia, and other five countries in central Asia shall be improved by setting offices and branches in each other’s countries. Chinese banks shall strengthen the financial support of energy projects in West Asia and North Africa, and expand network through mergers and acquisitions in the South Asia. Chinese banks should also develop financial business through increasing institutions in the Central and Eastern Europe. When deciding the “going global” model, Chinese banks could utilize the emerging trend on internet financing and establish cross-border e-commerce industrial parks along “Belt and Road” countries. To effectively prevent risks in international operations, Chinese banks shall strive to improve their international vision and actively prevent risks through strategic planning, compliance management, and environmental studies.

In conclusion, there still lies a long road ahead for Chinese bank to go global. They must fully recognize the disparity and learn from foreign banks to avoid detours.

While grasping opportunities from new policy and innovated technologies, Chinese bank must design their own roadmap of internationalization with steady expansion in overseas countries. With this strategy, Chinese shall be able to strengthen their positioning in overseas countries in long term.

For additional information and inquiries, please contact Gu Yue (guyue9401@163.com).

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中国人民大学国际货币研究所

INTERNATIONAL MONETARY INSTITUTE, RENMIN UNIVERSITY OF CHINA

Address: Room 605 Culture Square, No. 59 Zhongguancun Street, Haidian District, Beijing 100872

Tel: 010-62516755 Email: imi@ruc.edu.cn