universität wien

MASTERARBEIT/MASTER'S THESIS

Titel der Masterarbeit/Title of the Master Thesis

How the ownership participation of government influences the efficiency and management of China's banks

verfasst von/submitted by

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angestrebter akademischer Grad/in partial fulfilment of the requirements for the degree of

Master of Science (MSc)

Wien, 2019/Vienna, 2019

Studienkennzahl lt. Studienblatt/ Degree programme code as it appears on the student record sheet:	A 066 914
Studienrichtung lt. Studienblatt/ Degree programme as it appears on the student record sheet:	Masterstudium Internationale Betriebswirtschaft
Betreut von/Supervisor:	ao. Univ.-Prof. Mag. Dr. Jörg Borrmann

Abstract

This thesis analyses how the Chinese government influences the management and efficiency of China's most important commercial banks through government holdings. The analysis starts with the observation that both state-owned commercial banks (SOCBs) and joint-stock commercial banks (JSCBs) are heavily influenced by the public sector due to their ownership structures. The extent to which SOCBs and JSCBs use the reputation of the state influences their ability to attract deposits and to alleviate bank runs, while it also affects their motivation to adjust their strategies responding to change and their opportunities to reduce costs. Politician bank leaders might sacrifice the bank efficiency to achieve their political ambitions, and their presence is not limited to SOCBs. The remuneration of SOCB managers, which is restricted by the central government, impedes the motivation of SOCB managers and employees, but enables JSCBs to attract talents from SOCBs.

Key words: commercial bank, partial privatisation, bank efficiency, bank management, state-owned commercial bank, China

Acknowledgements

I am profoundly grateful to my supervisor, Professor Jörg Borrmann at the Department of Finance in University of Vienna. He provided very significant suggestions, remarks and comments when I faced difficulties in finding literature and ordering my thoughts. I express my thanks for his help from the beginning, in selecting the topic, to the end, with figuring out my mistakes in formatting and grammar. The thesis could not have been finished without his dedication and encouragement.

I also express gratitude to my friend, Dieyu Wang, who used her spare time to help me input some data from bank annual reports into Excel and extract data from Wind database. I thank her for her support and encouragement during the process. Finally, I need to thank my parents deeply for their material and spiritual support that gave me strength to further the study during the process.

Thank you all!

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List of Abbreviations

ABC	Agricultural Bank of China
BOC	Bank of China
BoCoM	Bank of Communications
CBIRC	China Banking and Insurance Regulatory Commission
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CEB	China Everbright Bank
CGB	China Guangfa Bank
CITIC	CITIC Bank
CMB	China Merchants Bank
CMBC	China Minsheng Bank
HXB	Huaxia Bank
IB	Industrial Bank
ICBC	Industrial and Commercial Bank of China
JSCB(s)	Joint-Stock Commercial Bank(s)
PAB	Ping An Bank
PBC	People's Bank of China
SASAC	State-owned Assets Supervision and Administration Commission
SOCB(s)	State-owned Commercial Bank(s)
SPDB	Shanghai Pudong Development Bank

Introduction

Motivation

After the 1980s, privatisation of public enterprises has been a main trend all over the world. It is believed that, if the government is less able to rectify the market failure in an industry, privatisation of state-owned enterprises in the industry will improve the efficiency and profitability of the privatised firms (Megginson & Netter, 2001, p. 381). According to the World Bank (Kireki & Kolo, 2006) from 1990 to 2003, more than US $400 billion has been generated through privatisation. The industries range from natural monopoly sectors such as infrastructure and utilities to comparatively more competitive sectors such as finance.

From 1978, following the pace of privatisation in the agricultural industry, the Chinese government gradually relinquished some of its economic power to the private sector. The restrictions on the banking industry were also gradually relaxed, and several reforms were conducted. In 1986, the banking industry was opened to joint-stock commercial banks (JSCBs), which increased the level of competition in the industry. In addition, the traditional 'Big Four' state-owned commercial banks (SOCBs)[1] were partially privatised and, finally, listed on the stock market. The city credit unions were encouraged to transform into city commercial banks, and some of the transformed city commercial banks also successfully went public. Although the banking industry appears to be much more open than before, the Chinese government maintains a certain level of control over almost all commercial banks, albeit to different degrees. The most obvious and direct control is imposed on the SOCBs. The wholly state-owned investment companies directly hold more than 50% of SOCB shares, and enterprises with

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[1] The four SOCBs are the Industrial and Commercial Bank of China (ICBC), the China Construction Bank (CCB), the Agricultural Bank of China (ABC) and the Bank of China (BOC).

government backgrounds also buy shares of the SOCBs listed on the stock market. The largest shareholders of 10 of the 12 JSCBs are either state-owned enterprises or state-controlled corporations. City commercial banks are more influenced by the local government, because the investment platform controlled by the local State Assets Supervision and Administration Commission (SASAC) is still one of the most significant shareholders of the city commercial banks.

China's banking reform has also raised research interest with regard to an efficiency comparison of China's banks. Regardless of the study period applied or the methodology used, SOCBs are generally found to be least efficient both before and after the reform, while JSCBs are most efficient (Fu & Heffernan 2007; Yao, Jiang, Feng, & Willenbockel, 2007; Ariff & Can, 2008; Fu & Heffernan, 2009; X. Lin & Zhang, 2009; H. Yin, Yang, & Mehran, 2013; Boateng, Huang, & Kufuor, 2015; Huang, Lin, & Chen, 2017). However, although the partial privatisation of SOCBs is often reviewed in the literature (Berger, Hasan, & Zhou, 2009, p. 114; K. Wang, Huang, Wu, & Liu, 2014, p. 6; Boateng et al., 2015, p. 5322), only few studies mention the government background of JSCBs (e.g., Fu, 2007, 2009). In addition, in the literature on bank privatisation, banks are usually not clearly differentiated from other state-owned enterprises. Theories and hypotheses proposed in the literature are based on the privatisation theory of normal state-owned enterprises (Clarke, Cull, & Shirley, 2005; Meggingson, 2005, p. 1936), while some special characteristics of banks are not often considered. Last but not least, as culture is a significant component of a country's institutions, some effects of bank privatisation could be amplified or attenuated by cultural factors. There do not exist enough studies that take cultural factors into consideration when analysing the effects of bank privatisation.

Approach

To analyse these questions, the methodology we will apply here is document analysis. The starting point will be data and information from regulatory institutions, and from annual reports and social responsibility reports provided by JSCBs and SOCBs from 2013 to 2017. Combining the collected information with theories discussed in the literature review, we will explore differences and similarities between SOCBs and JSCBs to answer the following research questions: Why, after partial privatisation, are China's SOCBs still least efficient, while JSCBs, that also have government holdings, are the most efficient? Are there any special characteristics of banks that influence the effects of privatisation? How does Chinese culture influence the efficiency of the partially privatised banks?

Structure

In this master's thesis, Section 1 introduces the current situation of China's banking industry: the ownership structure of SOCBs and JSCBs, and then People's Bank of China (PBC) and China Banking and Insurance Regulatory Commission (the two regulatory institutions of China's banking industry) and their regulatory tendencies. The literature review in Section 2 gives an overview of the existing theories in regard to privatisation, partial privatisation, bank privatisation and special characteristics of the banking industry, and Chinese culture based on the six-dimensional Hofstede model. Sections 3-5 combine the existing theories, current Chinese situation and Chinese culture with the necessary data to analyse how government participation in SOCBs and JSCBs influences their management and efficiency. Three elements will be discussed in each of these sections: trust and reputation in Section 3, characteristics of bank leaders in Section 4 and salary in Section 5. Based on the discussion, we will reach a conclusion at the end of the thesis.

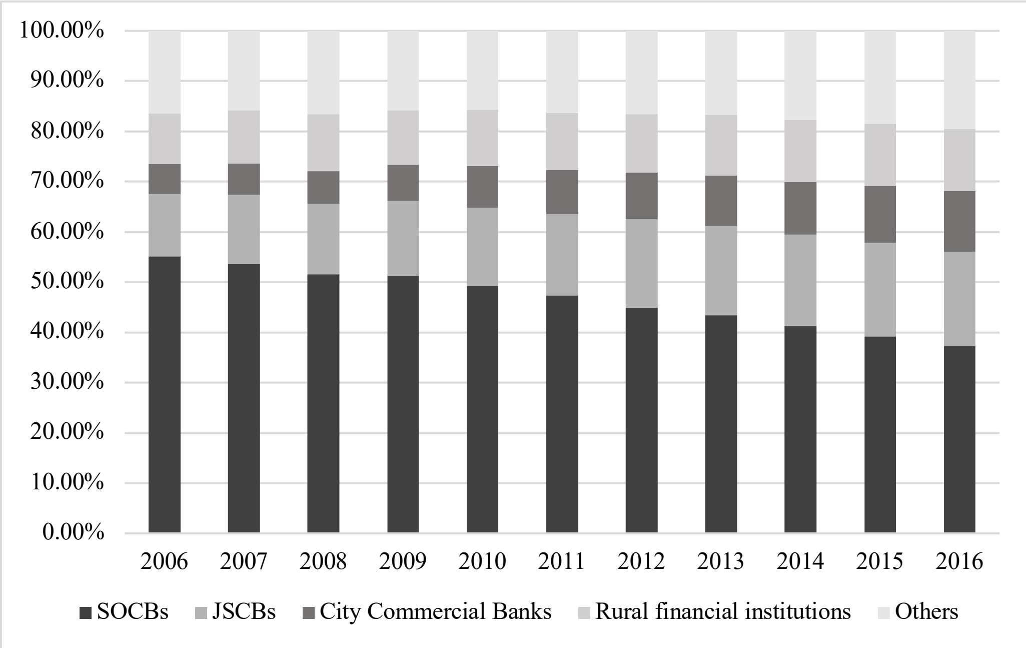
1. China's Banking Industry

1.1. Overview

According to the China Banking Regulatory Commission's 2016 Annual Report 2 (2017, pp. 28, 29), there are 4399 banking institutions with legal person status possessing assets worth RMB 232.25 trillion in China. The majority of China's banking institutions are rural, including 1,144 rural commercial banks, 1,125 rural credit cooperatives, 1,443 village banks and 38 rural credit union funds, which, however, accounted for only a 12.34% market share in China's banking financial industry in 2016. In contrast, five SOCBs, 12 JSCBs and 134 city commercial banks accounted for 68.16% of the market. Other banking financial institutions included a national development bank, policy banks, private banks, foreign financial institutions, financial asset management firms, trust companies, financial leasing firms, finance companies of enterprise groups, house savings banks and loan companies.

Figure 1 shows market share changes in China's banking financial institutions from 2006 to 2016. Although the five SOCBs still occupied more than one third of China's banking industry, their market share decreased continuously from 2006 to 2016. In 2006, the market share of SOCBs was 55.15%; it decreased to 47.34% in 2011, and in 2016 it decreased to 37.29%. During the same period, the market share of JSCBs and city commercial banks increased. In 2006, the market share of JSCBs was 12.39%; it increased to 16.22% in 2011 and to 18.7% in 2016. The market share of the city commercial banks more than doubled from 2006 to 2016, from around 5.90% to 12.16%. The total assets of the banking financial institutions increased from around 27.66 trillion RMB in 2006 to 232.25 trillion RMB in 2016.

Figure 1: Market Share Change of China's Banking and Financial Industry (by Assets)



Note. Market share = Assets of this category of banking institution/ total assets of banking institutions

Assets value from China Banking Regulatory Commission (2017, p. 204).

1.2. China's Commercial Banks

1.2.1. State-owned Commercial Banks

The five SOCBs, ICBC, CCB, ABC, BOC and Bank of Communications (BoCoM), are China's most significant commercial banks. They run nationwide businesses and own the largest number of commercial bank branches in China.[2]

[2] According to banks' annual reports (ABC, 2018a, p. 70; BOC, 2018, p. 57; Bank of Communications, 2018a, p. 106; CCB, 2018a, p. 58; ICBC, 2018a, p. 88), by the end of 2017, in mainland China, taking headquarters into consideration, BOC owned 10,674 branches, ICBC owned 16,324 branches, ABC owned 23,661 branches, CCB owned 14,920 branches and BoCoM owned 3,740 branches (BOC, 2018, p. 70; ICBC, 2018a, p. 89; ABC, 2018a, p. 59).

Before 1978, the People's Bank of China (PBC) worked as both the central bank and the monopolistic commercial bank. In 1979, BOC became independent from PBC (BOC, n.d.a), and CCB became independent from the Ministry of Finance (CCB, n.d.a). Subsequently, BOC focused on foreign exchange and CCB supported the construction sector. ABC was re-established to take over the rural banking financial business (Agricultural Bank of China, n.d.). In 1984, PBC focused on central bank responsibilities and finally gave up its industrial commercial banking function, and then ICBC was established (ICBC, n.d.a). The 'Big Four' SOCBs were wholly state-owned at that time. The situation of BoCoM is different; its role is more similar to a test field for commercial bank reform. Opened in 1987, BoCoM was the first JSCB in China, whose stockholders included the central government, regional governments and private firms (BoCOM, n.d.). Even today, the state is the largest shareholder of BoCoM but does not hold the majority of shares.

The partial privatisation reform of the five SOCBs was achieved in similar steps: dealing with the non-performing loans, introducing foreign strategic investors, and then being listed on the stock market.

Due to a lack of competition in the market, the Asian financial crisis in 1997 and banks' failure in selecting borrowers, SOCBs suffered from the problem of non-performing loans and became technically insolvent by the end of the 1990s (Berger et al., 2009, p. 117). The central government intervened and established four state-owned asset management firms,[3] one for each SOCB, to recapitalise them. Around 1.4 trillion RMB worth of non-performing loans were bought by the asset management firms and stripped from the four SOCBs in 1999 (Berger et al., 2009, p. 117). Although no asset management firm was established to resolve BoCoM's non-performing loans, its financial restructuring to deal with the non-performing loans and to

[3] These were China Orient Asset Management for BOC, China Cinda Asset Management for CCB, China Huarong Asset Management for ICBC and Great Wall Asset Management for ABC.

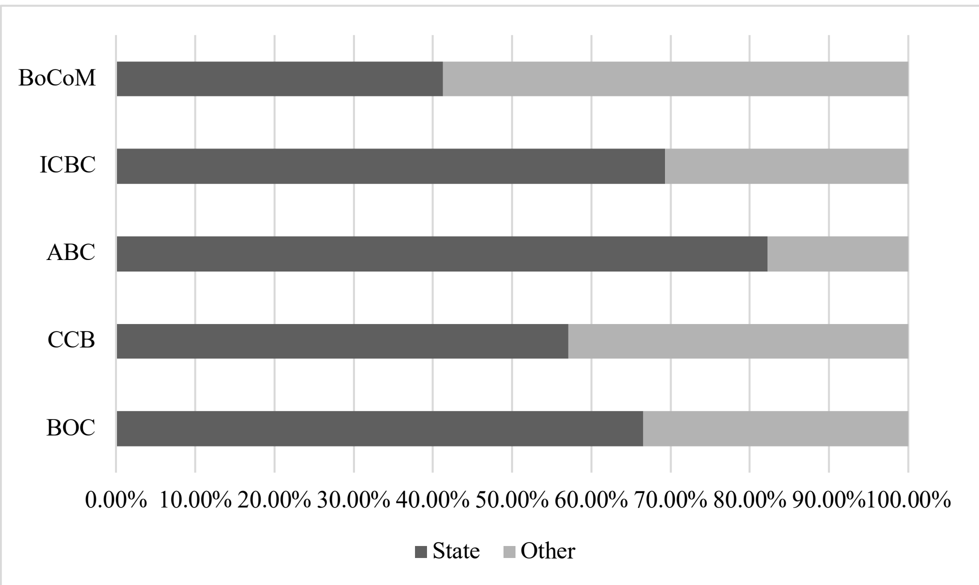
increase its capital adequacy ratio was also supported by the government. In June 2004, the Financial Ministry and Central Huijin Investment (wholly owned by the central government) injected 5 billion and 3 billion RMB, respectively, into BoCoM, and non-performing loans worth 41.4 billion RMB were packaged and then sold at half price to China Cinda Asset Management (BoCoM, 2016b).

The SOCBs then looked for foreign strategic institutional investors. In August 2004, HSBC reached an agreement with BoCoM to share 19.9% of BoCoM equity, at that time worth 14.46 billion RMB, and if it were allowed by regulation, HSBC would double the share at the stock price of BoCoM's initial public offering (IPO) (Bank of Communications, 2016b; Berger et al., 2009, p. 118). In 2005, CCB introduced Bank of America and Temasek, which bought around 9% and 5.1%, respectively, of BOC's stocks (Berger et al., 2009, p. 119). Also in 2005, the Royal Bank of Scotland and Temasek each bought 10% of BOC's shares (Berger et al., 2009, p. 119). Later, in 2006, Goldman Sachs Group, Allianz AG and American Express bought, in total, 10% of ICBC (Berger et al., 2009, p. 119). The investment contracts usually required the foreign strategic institutional investors to provide banks with assistance in risk management, corporate governance, internal control, financial management, asset and debt management and human resource management (BoCoM, 2006, p. 15; CCB, 2006, p. 6; BOC, 2007, p. 96-98; ICBC, 2007, p. 21).

The SOCBs were then encouraged by the government to list on the stock exchange, to accept supervision from the capital market. In June 2005, BoCoM was the first SOCB to conduct an IPO on the Hong Kong Stock Exchange and raised 17.40 billion RMB under overallotment (BoCoM, 2006, p. 36). In October 2005, CCB also issued an IPO on the Hong Kong Stock Exchange and raised about HK $71.58 billion (around 75.9 billion RMB) after exercising an overallotment option (CCB, 2006, p. 6). Two years later, in September 2007, CCB issued a public offering on the Shanghai Stock Exchange and raised 57.12 billion RMB (CCB, 2008, p.

14). BOC was listed on the Hong Kong Stock Exchange in June 2006, and it raised about HK $86.7 billion (around 89.3 billion RMB) through IPO under overallotment (BOC, 2007, p. 108). In July 2006, BOC was also listed on the Shanghai Stock Exchange, and it raised about 20 billion RMB (BOC, 2007, p. 108). ICBC went public in October 2006, and its IPO was conducted simultaneously on the Hong Kong Stock Exchange and the Shanghai Stock Exchange. ICBC raised HK $124.95 billion (around 126.95 billion RMB) on the Hong Kong Stock Exchange and 46.64 billion RMB on the Shanghai Stock Exchange (ICBC, 2007, p. 6). ABC was the last SOCB to go public, in July 2010, on both the Shanghai Stock Exchange and the Hong Kong Stock Exchange; it raised around 68.5 billion RMB on the former and HK $175.3 billion (around 208.6 billion RMB) on the latter (ABC, 2011, p. 87). In taking these step the SOCBs finished the first phase of their partial privatisation. As of 2017, although the government still holds majority shares in the 'Big Four' SOCBs and remains the largest shareholder in BoCoM, none of the so-called 'state-owned' commercial banks are wholly owned by the government (see Figure 2).

Figure 2: Shares of SOCBs Held by the State and Other Sectors in 2017



Note. Data from BoCoM (2018a, p. 82), ICBC (2018a, p. 73), ABC (2018a, p. 90), CCB (2018a, p. 84), BOC (2018a, p. 77)

The strategic institutional investors gradually sold their shares in China's SOCBs after the financial crisis, when the restricted stocks became tradable. The Royal Bank of Scotland sold its stock in BOC in January 2009 and raised around HK $18.47 billion (around 16.25 billion RMB) to alleviate the shock from the financial crisis (Tucker, 2009). Bank of America sold 13.1 billion shares of CCB worth US $8.3 billion (around 53.20 billion RMB) to satisfy the Basel III standards in 2011, and then sold its remaining shares in 2013, raising US $1.47 billion (around 9.07 billion RMB) (Bank of America, 2011; Barreto & Rudegeair, 2013). Also, in 2013, Goldman left ICBC and raised around US $10.1 billion (around 68.2 billion RMB) (Barreto & Rudegeair, 2013). However, the relation between BoCoM and HSBC has remained stable, and HSBC still owns 19.05% of BoCoM according to BoCoM's 2017 Annual Report (BoCoM, 2018, p. 82).

In 2015, BoCoM submitted a proposal to the State Council regarding further reform in SOCBs, which was approved. The plan included introducing private capital, exploring the possibility of an employee and management stock ownership plan, reforming the existing institutions, and reinforcing the human resource management reform and internal control reform (Reuters, 2015). Then, in 2016, BoCoM began to include the number of shares held by the directors, supervisors and senior managers in its annual report (BoCoM, 2017, pp. 119-120). As BoCoM has been the 'pathfinder' of SOCB reform, it is possible that further changes in China's SOCBs will be approved by the government. In addition, in the same year, Central Huijin Investment sold 438 million shares in ICBC. This could be a signal showing the possibility of ownership diversification in SOCBs.

1.2.2. Joint-Stock Commercial Banks

BoCoM was established in 1986, as the first JSCB in China. Shareholders included central government, local government and private institutions. From then on, the banking sector was gradually opened to non-SOCBs. JSCBs were primarily established and designed intentionally to decrease the ownership participation of government in banks. Central and local governments rarely directly hold shares of JSCBs, while state-owned enterprises and investment platforms usually initiate a bank and then partially hold it. Based on their ownership structure in 2017, we classify the JSCBs into three categories.

The first type of JSCBs are banks whose respective largest shareholders are central-government-owned enterprises. Four banks fall into this category: China Merchants Bank (CMB), China Everbright Bank (CEB), China CITIC Bank and China Guangfa Bank (CGB). The largest shareholder of CMB is China Merchants Group (29.96%), which is directly supervised by the State-owned Assets Supervision and Administration Commission of the State Council (CMB, 2018, p. 85). Similarly, China Everbright Group initiated the CEB and directly and indirectly in total holds 29.01% of CEB equity, and Central Huijin Investment holds 19.53% of CEB equity (CEB, 2018, p. 65); CITIC Group, wholly owned by the central government, indirectly holds 65.37% of China CITIC Bank (CITIC, 2018, p. 109); China Life Insurance Company Limited, which is 68.37% possessed by the central-government-owned China Life Insurance (Group) Company, holds around 43.69% of CGB (CGB, n.d.; China Life Insurance Company, 2018, p. 87).

The second type of JSCBs comprises banks that are partially owned by local-government-owned enterprises or even local government itself. Six banks fall into this category: Hua Xia Bank (HXB), Shanghai Pudong Development Bank (SPDB), Industrial Bank (IB), China Zheshang Bank, Hengfeng Bank[4] and China Bohai Bank. Wholly owned by the SASAC of Beijing Municipality, Shougang Group owns 20.28% of HXB equity, and PICC Property and Casualty Company Limited, 69% held by the central government-owned People's Insurance

[4] Hengfeng Bank did not release its 2017 and 2018 annual reports due to a corruption scandal involving HFB senior managers.

Company of China Group, owns 19.99% of HXB (HXB, 2018, pp. 64, 66, 67; PICC Property and Casualty Company Limited, 2018, p. 46). Similarly, Shanghai International Group is wholly owned by the SASAC of Shanghai Municipality, and directly and indirectly possesses 29.67% of SPDB equity (SPDB, 2018, pp. 89, 91). Zhejiang Provincial Financial Holdings is the financial investment platform belonging to the government of Zhejiang Province, and it holds 14.79% of CZB equity (CZB, 2018, pp. 88, 89). TEDA Holding, wholly owned by the SASAC of Tianjin Municipality, holds 25% of CBHB equity, and state-owned legal persons holds in total 62.01% of China Bohai Bank's share (China Bohai Bank, 2018, pp. 6, 7). Yan Tai Blue Sky Investment and Development holds 20.61% of Hengfeng Bank shares (Hengfeng Bank, 2017, pp. 16, 17); this company is wholly owned by Yantai City Government. The situation for IB is even more specific: the local government investment in the bank is not achieved through an investment platform but through the government itself, the Finance Bureau of Fujian Province directly holds 18.78% of the bank equity (IB, 2018, pp. 86, 88).

The third type of JSCBs are banks almost wholly owned by the private sector. Two banks can be classified in this category. Ping An Bank (PAB) and China Minsheng Bank (CMBC) are the only two JSCBs almost wholly owned by private institutional shareholders, and these two banks are somewhat special. The former name of PAB was Shenzhen Development Bank. It was originally established as a city credit union and then was transformed into a city commercial bank. From 2011 to 2013, through a series of mergers, acquisitions, refinancing and reorganization, Ping An Insurance (Group) Company of China became the largest shareholder of Shenzhen Development Bank and totally holds 59% of its shares. The name of Shenzhen Development Bank was then changed into Ping An Bank (PAB, 2014, pp. 83-87, 96, 99). Ping An Bank gradually developed as a nationwide JSCB. CMBC was initiated in 1995 by several private firms, and its ownership structure is highly diversified. No shareholder holds more than 7% of CMBC equity (CMBC, 2018, p. 110).

1.2.3. City Commercial Banks

There are now 134 city commercial banks in China, operating regionally. Compared with SOCBs, city commercial banks are controlled more by local government than by central government. They have a smaller scale and a more diversified ownership structure than the other two types of commercial banks.

The precursors of the city commercial banks are the city credit unions, which initially were spontaneously established by local citizens. In 1986, the Provisional Regulations of the People's Republic of China on the Control of Banks issued by the State Council admitted the legal status of city credit unions, and, in 1988, PBC raised the registered capital threshold for setting up a city credit union from 100,000 RMB to 500,000 RMB (People's Bank of China, 2009). By the end of 1993, there were around 4,800 city credit unions in China, holding 187.8 billion RMB. Beginning in 1995, some qualified city credit unions were restructured into city commercial banks, and PBC prohibited the establishment of new city credit unions. By the end of 1999, 2,300 city credit unions had been transformed into 90 city commercial banks. The process continued until 2012 when Ningbo Xiangshan City Credit Union, as the last city credit union, was transformed into a city commercial bank (Zheng & Chen, 2013; CBRC Ningbo Office, 2013).

Although city credit unions were established independently, local governments played a significant role in restructuring them into city commercial banks. Because of the inability in risk management and the high level of non-performing loans, city credit unions accumulated high risks and the finally threatened financial stability (People's Bank of China, 2009). City commercial banks were implemented as the solution. During the process of implementation, local governments not only provided equity to newly established city commercial banks but also helped to attract new institutional investors. Even today, according to the annual reports of publicly listed city commercial banks, local governments still partially own their respective city commercial banks. For instance, Beijing State-Owned Asset Management holds around 8.63% of Bank of Beijing’s equity, and Zijin Investment Group (wholly owned by Nanjing City Government) is the second largest shareholder of the Bank of Nanjing (12.41%) (Bank of Beijing, 2018, pp. 46, 47; Bank of Nanjing, 2018, pp. 94, 96).

Compared with SOCBs and JSCBs, city commercial banks operate on a much smaller scale. The Bank of Beijing, as the largest city commercial bank in terms of assets, held 2.33 trillion RMB in assets by the end of 2017, which is around 26.39% of the total assets of BoCoM (the smallest SOCB) (BoCoM, 2018, p. 6; Bank of Beijing, 2018, p. 18).

Another characteristic of the listed city commercial banks is their less concentrated and more diversified ownership structure. Firstly, foreign institutional investors sometimes can be important bank shareholders, and there is little difference in proportion between government-held equity and that of foreign institutional investors. For example, the largest shareholder of Bank of Beijing is ING Bank NV (13.03%), and Hong Leong Bank Berhad is the second largest shareholder of Bank of Chengdu (19.99%), holding only 0.08% less in shares than the local government (Bank of Beijing, 2018, p. 45; Bank of Chengdu, 2018, p. 66). Secondly, domestic private institutional investors are also important. Shengjing Bank, for example, Shengjing Bank is the city commercial bank of Shenyang, whose largest shareholder is Evergrande Group, a private real estate developer headquartered in Guangdong province (Shengjing Bank, 2018, p. 74).

1.3. China's Regulatory Institutions

There are now two vital institutions regulating China's commercial banks: PBC (the country's central bank) and the China Banking and Insurance Regulatory Commission (CBIRC). PBC is a department constituting the State Council, and CBIRC is a public institution directly under the State Council. Both are institutions of the government (State Council of The People's Republic of China, 2018).

1.3.1. The People's Bank of China

PBC was established in 1948 by the consolidation of Huabei Bank, Beihai Bank and Xibei Farmer Bank. From 1948 to 1979, PBC worked as both a monopolistic commercial bank and the central bank of the economy. On the one hand, the source and application of credit funds nationwide were centralised to PBC; on the other hand, PBC was responsible for currency circulation management (Bell & Feng, 2013, p. 55). After 1979, the commercial bank function of PBC gradually became independent. In 1983, the State Council decided that PBC should focus on such defined central bank functions as researching and making macro-finance policy decisions and sustaining currency stability. Then, in 1995, the status of PBC as the central bank was legitimated. The China Insurance Regulatory Commission was established in 1998 to take over PBC's supervisory function in regulating the insurance industry. In 2003, PBC's supervisory function with regard to regulating banks, financial asset management companies and deposit financial institutions was divided, and the China Banking Regulatory Commission (CBRC) took over these functions (PBC, n.d.a). Nowadays, PBC focuses on macro-level financial and monetary policy. According to the major functions defined by PBC on its website, its most important functions directly related to micro-level commercial banks are formulating and implementing monetary policy, especially the reserve requirement ratio and the central bank base interest rate and regulating the inter-bank lending market (PBC, n.d.b).

Compared with other central banks such as the European Central Bank or the Federal Reserve System, PBC utilised the reserve requirement ratio much more frequently than the bank base interest rate. From 2004 to 2018, the reserve requirement ratio has been changed more than 40 times; indeed, in 2008, it was altered almost every month. In addition, the reserve requirement ratio has remained at a high level in China. Since April 2007, it has never dropped below 10%, and it peaked in 2011, at 21.5% for large financial institutions and 19.5% for medium and small financial institutions (Eastmoney, n.d.).

The central bank base interest rate is now provided as a reference for banks in setting interest, rather than as a standard that is insisted upon. Early in 2004, PBC nullified the ceiling for the loan interest rate, and, in July 2013, the floor for the loan interest rate was also removed (Reuters, 2013). In October 2015, PBC nullified the final ceiling for the deposit rate, which implies that since then, China's interest rate has been liberalised, in theory (Monetary Policy Department, 2015). Before the liberalisation of the interest rate, the central bank base interest rate played a significant role for commercial banks in setting their own interest rate. The central bank base interest rate was provided as a benchmark, around which a float range was fixed. For instance, on 8 June 2012, PBC decreased the central bank base interest rate by 0.25% and simultaneously required the deposit interest rate ceiling to be 1.1 times the central bank base deposit interest rate, and the credit interest rate floor to be 0.7 times the central bank base credit interest rate (Reuters, 2013).

1.3.2. China Banking and Insurance Regulatory Commission

China Banking Regulatory Commission (CBRC) was established in March 2003, and then started to perform its duties from April in that year (CBRC, 2014). Apart from its supervisory and regulatory functions, the CBRC is also responsible for testing the senior managerial personnel of the banking institutions, and publishing statistics and reports for the banking industry (CBRC, n.d.). In March 2018, the State Council Institutional Reform Plan of 2018 was approved by the National People's Congress. The CBRC and the China Insurance Regulatory Commission were consolidated into the China Banking and Insurance Regulatory Commission (CBIRC). Their responsibilities to formulate significant drafts of laws and regulations for banking and insurance industries and for prudential regulation of the basic system have been incorporated into PBC (Wei, 2018).

The regulation of the CBRC expressed a tendency towards increasing openness. Ownership participation in commercial banks has gradually been opened, not only for foreign investors but also for domestic private investors.

When the CBRC was established, China had just joined the World Trade Organization, and the promised to open the banking industry to foreign banks. However, the government was initially conservative about foreign investment in China's banks. Even the strategic investors in SOCBs were seriously restricted. In 2003, Measures for the Administration of the Investment and Shareholding in Chinese-funded Financial Institutions by Foreign Financial Institutions issued by CBRC mandated that no single foreign financial institution was allowed to have an investment share of more than 20% in China's commercial bank. In addition, any non-listed financial institution that had more than 25% foreign investment would be regarded as a foreign financial institution. In 2006, when the SOCBs were striving for IPOs, CBRC issued a regulation guidance specially for SOCBs. The guidance strictly regulated the proportion of the share that foreign strategic investors were allowed to hold, the length of their holding and the number of SOCBs they were allowed to hold shares in (China Banking Regulatory Commission, 2006). These regulations were in place for more than 10 years. On 17 August 2018, the CBIRC removed these regulations (China Banking and Insurance Regulatory Commission, 2018).

Recently, the market has also been opened to domestic private banks. Although the first attempt to establish private banks was been made in 2003, the plan was denied by the CBRC, which halted efforts to form private banks for the next several years. In 2012, based on opinions given by the central government, the CBRC clarified that private companies are allowed to initiate commercial banks and hold bank shares. However, it was not until 2014 that the CBRC allowed five pilot private banks that were supposed to undertake risks by themselves (Anderlini, 2014). In 2016, based on the experience of these five banks, the CBRC issued Guiding Opinions of the China Banking Regulatory Commission on the Regulation of Private Banks (2016) – which is still, however, relatively obscure.

2. Literature Review

China's banking sector can be regarded as currently undergoing a privatisation process. Therefore, it is meaningful firstly to have a look at the existing arguments related to privatisation. In addition, as the present ownership structure of China's banks resembles partial privatisation, it is also necessary to review the literature on partial privatisation. What is more, as banks have some significant characteristics that are different from non-financial production firms, we will also explore existing research regarding the peculiarity of banks and privatisation of banks. Finally, we will examine empirical research pertinent to China's privatisation of banks specifically.

2.1. Privatisation

Since 1979, following the steps of privatisation in the United Kingdom, the world has witnessed waves of privatisation. According to the World Bank (Kireki & Kolo, 2006), from 1990 to 2003, more than US $400 billion has been generated through privatisation. The industries undergoing privatisation range from such natural monopoly sectors as infrastructure and utilities to comparatively more competitive sectors such as finance. The main issue concerning privatisation is the improvement of efficiency. The relevant theoretical arguments include such fields as welfare economics, principal-agent theory and property rights theory.

The welfare economists' arguments are based on the first theorem of welfare economics: in a complete market, if preferences are locally nonsatiated, a competitive equilibrium will bring about Pareto efficiency. Megginson and Netter (2001) reviewed the body of privatisation studies and indicated that, if the government is less able to rectify the market failure in an industry, then the privatisation of firms in the industry generates more efficiency. Apart from the existence of market failure, competition can also play an important role. Sheshinski and López-Calva (2003) suggested it is only in a competitive environment that the improvement of profitability of privatised firms can be regarded as the improvement of efficiency. However, Shleifer (1998) argued that, even if a natural monopoly exists, public ownership by a benevolent government should still be limited to a few cases. Matsumura and Shimitsu (2010) showed that, if the publicly owned enterprises compete with private firms, even if the initial privatisation of public firms does not bring about sufficient welfare improvement, a series of privatisation actions would eventually lead to a turning point after which there would be ample welfare gains for the whole society.

The irrelevance theorem formulated by Sappington and Stiglitz (1987) laid a foundation for arguments based on agency theory. The theorem implies that, without asymmetric information, there is no difference between public production by a benevolent government and delegated private production by a risk-neutral firm. However, contracting ability, transaction costs, institutional restrictions and problems initiated in contract implementation make irrelevance impossible. General agency theory argues that state ownership causes a rift between control and ownership; through privatisation, managers have stronger incentives to improve internal efficiency (Arocena & Oliveros, 2012). Based on the irrelevance theorem, Martimort (2006) took contractual incompleteness[5] into consideration, and then points out that incompleteness affects both state ownership and privatisation, and sometimes state ownership can even dominate.

Soft budget constraints also provide an explanation for the inefficiency of public firms and the possibility of improvement through privatisation. An organisation with soft budget constraints expects that, even if it cannot cover its financial deficits, it does not necessarily have to cease its activity, because a supporting organisation will rescue it (Kornai, Maskin, & Roland, 2003). In public ownership, the government plays the role of a supporting organisation. Therefore, the managers of public firms do not suffer from the economic results of their decisions, leading to the generation of economic waste (Arocena & Oliveros, 2012). Through privatisation, management is trained to observe financial discipline, budget constraint is hardened, and efficiency can be increased. It is worth mentioning that, by comparing the privatisation process in different post-socialist countries of Eastern Europe, Kornai (2001, p. 1589) demonstrated that simple privatisation is not enough to harden budget constraints. A dominant role for the private sector in the economy, comparatively transparent government tax utilisation, a weaker

[5] Contractual incompleteness may result from a lack of commitment, limited state control, non-benevolent government and fragmented government.

link between the owners of newly privatised firms and the government, and appropriate institutional conditions are also required.

2.2. Partial Privatisation

Although privatisation is prevalent around the world, it seems that governments still retain a high level of control in privatised firms (Bortolotti & Faccio, 2008). As discussed in the first section, this is also true in China's banking industry.

There exist various motivations of government to conduct partial privatisation. Chernykh (2011) investigates the renationalisation situation in Russia, suggesting that government has an incentive to retain a certain level of control in strategic industries. Using employment level and firm value as standards, Li and Yamada (2015, p. 188) proffer evidence that China's government pursues both political targets and economic efficiency through partial privatisation of state-owned enterprises. However, they also admit that the Chinese government's preoccupation with economic efficiency can be regarded as a measure to achieve its political goals.

The existing research on partial privatisation remains at a comparatively theoretical level. Studies are based on the mixed-oligopoly and duopoly market form, in which market entry conditions (Matsumura & Kanda, 2003), the varieties of products (Fujiwara, 2007; Wu & Ma, 2015), the ownership relation between the partially privatised firms and the private firms (Jain & Pal, 2012; Wu & Ma, 2015), competition in different areas (Ishibashi & Kaneko, 2007; Heywood & Ye, 2009) and decision-making process in the partially privatised firms (Nakamura & Takami, 2015) are taken into consideration. In general, these studies have concluded that partial privatisation can maximise social welfare, with the difference being the degree of partial privatisation. Table 1 shows the existing literature on partial privatisation and the main results.

However, as mentioned by Matusmura (1998, p. 479), the partial privatisation model ignores the potential gains of full privatisation. Furthermore, in reality, partially privatised firms rarely compete against private firms in a duopoly or oligopoly market. What is more, the potential power discrepancy between public parties and private parties, which influences not only the partially privatised firms but also the whole market situation, is not mentioned.

Table 1: Studies on Partial Privatisation

Study	Market form	Conclusion
Matsumura (1998)	Mixed duopoly; a private firm and a partially privatised firm	If the private company and the partially privatised company have the same cost function and pursue weighted firm profits and social welfare, it is optimal for the government to partially privatise the public company.
Matsumura and Kanda (2003)	Mixed oligopoly; one public firm and free entry of private firms	The partially privatised firm should in the long run become wholly state owned. But if the firm does not earn a profit, it should be abolished rather than privatised.
Fujiwara (2007)	Mixed oligopoly with differentiated products	The welfare generated by partial privatisation in the long run increases monotonically with consumers' love of variety.
Ishibashi and Kaneko (2007)	Mixed duopoly with price and quality competition	Compared with wholly state-owned public firms and wholly privatised public firms, a partially privatised public firm is efficient to secure quality and to improve social welfare.
Heywood and Ye (2009)	Mixed duopoly with research and development rivalry	A smaller extent of partial privatisation can maximise social welfare.
Jain and Pal (2012)	Cross ownership in mixed duopoly	If the privatisation degree of the public firm is not high enough, cross ownership is not profitable for private firms.
Nakamura and Takami (2015)	Mixed oligopoly, but the public party and the private party within the partially privatised firm bargain with each other to make decisions	Partial privatisation is still optimal, but government should maintain a larger proportion of ownership.
Wu and Ma (2015)	Multi-product mixed duopoly with cross ownership	A lower level of public ownership in the partially privatised firm can lead to better stability in a mixed market.

2.3. Banks and Bank Privatisation

The banking industry is more complex than the normal production industry. There are several reasons why governments strictly regulate this industry. Firstly, banks play the role of a financial intermediary, in which they buy financial claims from depositors and sell them to creditors. The lenders are usually households and individuals, and the borrowers are usually firms and enterprises; both are tightly related to economic prosperity and social stability. The stability of the banking industry is therefore significant in a country's economy. In addition, because banks also play a role as a transmission channel of monetary policy, the performance of banks also influences the central banks' ability in terms of macro-control. Apart from that, due to the interdependence among banks, financial innovation and the existence of global financial institutions, the fall of a large commercial bank could bring about a chain reaction with significant effects on the global economy.

On the one hand, banks are significant for depositors. Benston and Smith (1976) placed transaction cost analysis at the core of their explanation for the existence of financial intermediaries. They argued that financial intermediaries help depositors reduce transaction costs when making consumption-smoothing decisions. Diamond and Dybvig (1983) suggested that, in a competitive market, demand deposits can achieve optimal risk sharing, which provides depositors with liquidity when they are faced with random risks. In addition, banks also play a role in delegated monitoring. Ramakrishnan and Thakor (1984) indicated that there are economies of scale to having a financial intermediary as an information broker in screening potential borrowers. Diamond (1984) argued that, because of the existence of moral hazard problems, high individual monitoring costs and free-rider problems, banks diversifying and working as monitors on behalf of lenders provides cost advantages.

On the other hand, banks also benefit borrowers, usually firms and investors. Holmström and Tirole (1998, p. 19) indicated that banks can provide liquidity to firms when they are faced with idiosyncratic liquidity shocks. Boot and Thakor (1997, p. 727) argued that, due to the existence of moral hazard, borrowers with unobservable reputation access banking finance instead of the capital market, which implies that banking finance could be especially meaningful for start-ups and small and medium enterprises.

Not only are banks significant for individual depositors and firms, they are also important for central bank monetary policy. Through the reserve requirement ratio and policy interest rate, banks act as a basic and essential transmission channel influencing the economy. Firstly, the special role of banks as money creators could influence the currency supply in an economy. The most frequently taught theory regarding banks' money creation concerns the deposit multiplier effects from bank lending and reserve requirements from the central banks. It is expected that, in a banking system with a sufficient number of banks, the central bank can effectively influence the money supply through changing reserve requirements, and the money-supply multiplier is the reciprocal of the required reserve ratio (Samuelson & Nordhaus, 2005, p. 519). Tobin (1963, p. 16) argued that, what makes the money creation through banks possible is not the expansion on loan assets, but the existence of reserve requirements and interest ceilings. However, Werner (2014) argued that, through lending behaviour, banks are allowed to reclassify their 'accounts payable' as customer deposits, which enables banks to create money by themselves without influenced by the central banks. This argument implies that equity adequacy and reserve requirement may not be enough to regulate banks, and further regulation reforms should be contemplated.

Apart from the required reserve ratio, commercial banks are also influenced by the policy interest rate and influence the economy in turn. After the 2008 financial crisis, an increasing number of studies have focused on how the interest rate policy influences the risk-taking behaviour of banks. For instance, Diamond and Rajan (2012, p. 581) demonstrated that the expectation of a low interest rate can lead to a vicious circle: a low interest rate promised by the central bank makes even rational banks engage in risk-seeking behaviour, which worsens the liquidity crisis banks are faced with; and then, to alleviate the crisis, central banks will have to promise extended low interest rates, and so on.

As mentioned, banks are significant both for private market participants and for central bank monetary policymaking. However, financial fragility, systemic risk and the contagion effect in the banking industry can deteriorate the economic situation during a crisis or even trigger a financial crisis. Diamond and Dybvig (1983, p. 402) demonstrated that demandable deposit contracts offer depositors better risk-sharing when they are faced with random risks, but this includes a bank-run equilibrium. When depositors panic, those who would have preferred to withdraw their deposits later will withdraw immediately as they recognise banks' failure potential. Even a 'healthy' bank is forced to recall loans as soon as possible, which stops productive project investment in the economy. Diamond and Rajan (2001) argued that, because of a limited ability to fully transfer the specialised human capital of asset users, the value generated by assets cannot be sold or borrowed at full price due to moral hazard. At the same time, due to the limited ability to transfer a relationship lender's capacity in collecting future repayment of loans, a relationship lender cannot sell the holding loans at full present value when it is in need of liquidity. However, a bank as relationship lender with persistent loan collection ability can solve the problem. Banks issue demand deposits when they are threatened by a bank run, which generates enough liquidity to asset users and simultaneously guarantees that banks can fully use their loan collection ability. Bank fragility is endogenous and intentional but can generate liquidity in an economy.

If a single bank is threatened by a bank run it may collapse, and this collapse can induce a chain reaction that threatens the whole banking industry. De Vries (2005, p. 804) argued that, on the asset side, banks participate in an inter-bank market and syndicated loans that make them mutually connected. The failure of a bank in collecting its (syndicated) loans from a large firm could lead to the default of the bank in paying back its own loans on the inter-bank market. This failure can further induce the loan default of the lending bank on the inter-bank market, if the lending bank waits for the refund to pay back its loans borrowed from a third bank. Following such steps, a chain reaction starts, and the banking system could eventually fail. On the liability side, De Vries (2005, p. 804) argued that because deposits are regarded as substitutes for other assets by depositors, once the interest rate changes, depositors rapidly rearrange the asset allocation. The change in interest rate quickly influences the liquidity needs of a bank. If a bank run happens during this process, this, too, can cause the banking system to fail. In addition, Schooner and Taylor (2009) figured out that, because the payment system links banks together, uncertainty in the arrangement for clearing settlement of payments among banks could be the most important factor leading to a systemic failure. If one bank fails in fulfilling its settlement obligation, other linked banks may also be unable to fulfil their obligations.

Due to such characteristics of the banking industry, it is generally expected that government has the responsibility to regulate banks. Regulation tools such as capital adequacy requirements, reserve requirement ratios, and corporate governance are generally accepted and implemented by central banks and regulation institutions. However, the effects of such regulations are ambiguous, especially after the financial crisis. As mentioned before, Werner (2014) argued that reserve requirement ratios is not enough to regulate banks, because banks can create money independently from the influence of the ratio. A low interest rate aimed at spurring the economy during a crisis can eventually lead to a more serious crisis (Diamond & Rajan, 2012). In addition, although it is expected that the increased liquidity constraints due to Basel III will not seriously affect macro-economic growth (Slovik & Cournède, 2011; Fidrmuc & Lind, 2018), potential risks lie in the uncertainty regarding the ability of banks to accommodate their business models, business processes and governance to the new regulatory institutions (Allen, Chan, Milne, & Thomas, 2012). Additionally, the focus of the existing regulations on the ‘health’ of individual banks is based on the assumption that, if individual banks are ‘healthy’ this will bring about a stable financial system. However, studies after the financial crisis showed that less-risky individual banks cannot ensure a more stable financial system, especially when we take financial innovations into consideration (Acharya, 2009; Beale et al., 2011; Nijskens & Wagner, 2011).

Even though banks need regulations, and regulations need improving, it is rare for governments to wholly own commercial banks as a regulation method, especially after the liberalisation and privatisation waves of the 1980s.[6] Less efficient banks are privatised in both developing and developed countries. In developing countries, even though the banking sector maturity and the local political environment significantly affect the decision, banks are still gradually being partially or wholly privatised (Boehmer, Nash, & Netter, 2005). Clarke et al. (2005) reviewed the bank privatisation situation in 11 developing countries. They hypothesised that bank privatisation will improve bank performance. In addition, complete privatisation, sales to strategic investors, allowing foreign ownership and a competitive banking sector will bring about greater gains in performance. According to a summary of empirical studies, private banks are more profitable, more productive, more able to cope with crises, and less influenced by politicians than state-owned banks (Megginson, 2005). Through bank privatisation, developed countries have clearly improved their bank performance and efficiency. Privatised banks in transition economies can also benefit from privatisation strategies without continued government intervention, and the performance of banks privatised in non-transitioning developing countries are also improved in the long run after a period of trial and error (Megginson, 2005).

[6] There are some examples, however. Cho and Kalinowski (2010) reviewed the Korean government intervention during the Asian financial crisis. They showed that bank nationalisation and prompt public funds injection were essential for post-crisis bank restructuring, but banks were re-privatised after the crisis. Another example is the United Bank of India, whose history was reviewed by Mallick and Marjit (2008). The bank was nationalised by the Indian government in 1969. It was expected that this would bring about fairer resource distribution and more employment opportunities. At the time of this writing, the bank is still wholly government owned.

China's banking reform has also attracted research interest in terms of an efficiency comparison of China's banks (see Table 2). Several empirical studies have been conducted, which have produced two results in common regardless of methodology or study period. Firstly, SOCBs are generally found to be the least efficient, both before and after the reform, while JSCBs are the most efficient (Fu & Heffernan 2007; Yao et al., 2007; Ariff & Can, 2008; Fu & Heffernan, 2009; Lin & Y. Zhang, 2009; Yin et al., 2013; Boateng et al., 2015; Huang et al. 2017). Secondly, foreign banks are more efficient than China's banks, and foreign investment is positively associated with banks' high efficiency (Yao et al., 2007; Berger et al., 2009; Boateng et al., 2015; X. Lin & Y. Zhang, 2009; Jiang, Yao, & Feng, 2013). Both results reached by the empirical literature are not surprising and are consistent with theories regarding privatisation and efficiency.

Table 2: Overview of Empirical Studies on China's Bank Efficiency

Study	Description of methodology, sample and study period.	Summary of empirical findings and conclusions
Fu & Heffernan (2007)	Employ the stochastic frontier approach (SFA) to investigate cost X-efficiency of China's 'Big Four' SOCBs and 10 JSCBs from 1985 to 2002.	Compared with the 'Big Four' state-owned commercial banks (SOCBs), joint-stock commercial banks (JSCBs) are found to be relatively more X-efficient during the study period, but they are still less X-efficient according to international standards. There is a potential to improve X-efficiency of China's banks through converting SOCBs into joint-stock ownership and reducing reliance on purchased funds.
Yao et al. (2007)	Apply the SFA approach to evaluate the average efficiency of 22 of China's banks before China joined the World Trade Organization (1995-2001).	In both profit and loan models, the estimated average efficiency of the 22 banks is lower than that of US banks. The efficiency of SOCBs has not improved during the study period even though there were bank reforms. The JSCBs outperformed the SOCBs during the study period, both in profitability and in loans.
Ariff & Can (2008)	Employ a non-parametric DEA based technique to investigate the cost and profit efficiency of the 'Big Four' SOCBs, nine JSCBs and 15 city commercial banks from 1995 to 2004.	The banks' profit efficiency level was below the cost efficiency level during the study period. JSCBs were on average the most efficient banks among the three types of banks, while SOCBs wereleast efficient.

Berger et al. (2009)	Test the differences in average profit and cost efficiency for the 'Big Four' SOCBs, 10 JSCBs, 16 city commercial banks, six foreign joint venture banks and two solely foreign banks from 1994 to 2003.	Minority foreign ownership is associated with higher profit and cost efficiency level. Non-Big Four SOCBs and majority foreign banks are most cost efficient. The 'Big Four' SOCBs are least profit efficient but only a bit more cost inefficient than the average level.
Fu and Heffernan (2009)	Employ SFA to examine the market power and efficient structure hypotheses. Data from 1985 to 2002 from the 'Big Four' SOCBs and 10 JSCBs are used.	From 1985 to 1992, the relative market power hypothesis best describes China's banking sector. From 1993 to 2002, no evidence is found that the efficiency positively influences the market structure. For the 'Big Four' SOCBs, concentration is not found to be significantly negatively related to efficiency improvement. JSCBs become more X-efficient, but the market structure does not change.
X. Lin and Y. Zhang (2009)	Evaluate the static, selection and dynamic effects of China's 60 banks from 1997 to 2004.	The 'Big Four' SOCBs, in the long term, are less efficient than JSCBs and city commercial banks. Banks with future foreign acquisitions or public listing outperform banks without future ownership change. Foreign acquisition does not bring about performance improvement.

Heffernan and Fu (2010)	Four indexes (Economic Value Added, the Net Interest Margin, Return on Average Equity and Return on Average Assets) are used to evaluate the performance of China's 'Big Four' SOCBs, 13 JSCBs, 51 city commercial banks and eight rural commercial banks from 1999 to 2006.	During the study period, only rural commercial banks brought about economic value added to shareholders. In addition, rural commercial banks outperformed the other three types of banks. Listing on the public market and foreign equity investment do not significantly enhance bank performance.
Matthews and N.X. Zhang, (2010)	Employ a bootstrap method for the Malmquist index, and examine the productivity growth of five SOCBs, nine JSCBs and 47 city commercial banks from 1998 to 2007.	Total factor productivity growth was neutral for SOCBs and JSCBs, but positive for city commercial banks from 2003 to 2007. Technical innovation was generated by benchmark banks, leading to a gap between them and other banks in their group. The technical innovation is achieved through banks' revenue diversification from non-interest rate earnings. Efficiency gains were generated through cost reduction. There was only evidence showing innovation and reform of city commercial banks during the opening up of the Chinese banking market (2003 to 2007) leading to improvement in bank productivity. In addition, city commercial banks improved technical progress from 2003 to 2007, leading to total factor productivity growth.

Yin et al. (2013)	Use SFA to document the technical efficiency of 171 of China's domestic commercial banks and 38 foreign banks from 1999 to 2010.	China's banks were more efficient in generating loans than making profits. JSCBs were the most efficient banks. The efficiency of China's banking system increased after China joins WTO. The five SOCBs are more efficient than foreign banks with the profit model, but they are less efficient with the loan model. During the study period, the five SOCBs and city commercial banks showed an efficiency gain in the profit model, but JSCBs and foreign banks did not show this trend. Foreign banks gained efficiency during the period with the loan model. Banks with majority state ownership were less efficient. Risk-averse banks were less efficient during the period. Bank efficiency declined with bank size growth until the bank was large enough to achieve economies of scale leading to higher efficiency. Banks focusing on off-balance-sheet fee earnings were less efficient than banks focusing on traditional loan-issuing business.
Jiang et al. (2013)	Employ SFA to evaluate how ownership and privatisation influence the performance of the 'Big Four' SOCBs, 13 JSCBs and 32 city commercial banks from 1995 to 2010.	SOCBs are both cost inefficient and profit inefficient. JSBSs are most cost efficient. CCBs are most profit efficient. Listed banks with non-concentrated ownership structure are more efficient. Banks with minor foreign ownership are most profitable. IPO improves bank efficiency both in the short run and in the long run, and minor foreign ownership makes the effect more significant in long run.

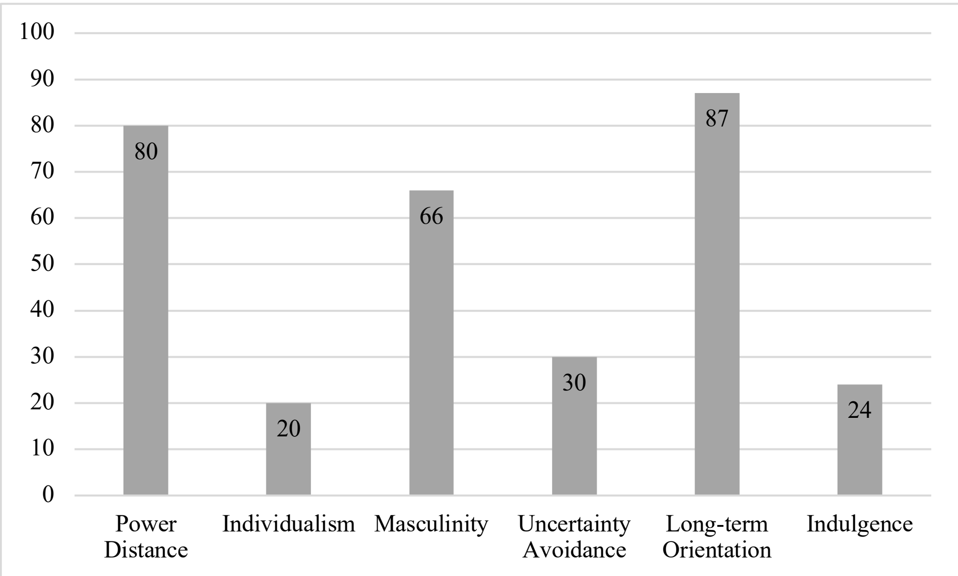
K. Wang et al. (2014)	Employ the two-stage DEA model to evaluate the efficiency of China's 'Big Four' SOCBs and 12 JSCBs from 2003 to 2011.	There exists an overall efficiency improvement after the reform. SOCBs were only more efficient than JSCBs before the reform, but the efficiency of the two types of banks were similar after the reform. Without measures used to strip off non-performing loans, the banking system would be slightly less efficient. For a given bank, whether one includes a measure used to deal with non-performing loans would significantly influence the bank efficiency evaluation. Jointed equity reform in SOCBs improves their efficiency.
Boateng et al. (2015)	Use the quality of asset, profitability, liquidity and overall performance as standards to evaluate the performance of 111 commercial banks in China (including five SOCBs, 21 foreign banks and 85 non-state-owned commercial banks) from 2000 to 2012.	Foreign banks have better performance than SOCBs and China's non-state-owned commercial banks. SOCBs have worse asset quality but better profitability and liquidity than China's non-state-owned commercial banks. Banks with lower financial leverage have better overall performance. Bank performance is negatively associated with GDP growth rate and per capita GDP. Inflation and unemployment rate are positively related to bank performance.
Zha et al. (2016)	Employ the dynamic two-stage DEA model to evaluate the efficiency of SOCBs, JSCBs and eight city commercial banks from 2008 to 2012.	During the study period, China's banks were technically inefficient and scale inefficient. City commercial banks outperformed both JSCBs and SOCBs in overall efficiency level.

Huang et al. (2017)	Employ a stochastic network model under the framework of SFA to identify the technologies and evaluate the technical efficiency of five SOCBs, 12 JSCBs and 82 city and rural commercial banks from 2002 to 2015.	JSCBs are the most technically efficient among the banks. Banks are recommended to take advantage of non-exhausted economies of scale and economies of scope to improve efficiency.

2.4. Chinese Culture According to Hofstede's Six Dimensions

Hofstede and colleagues define culture as 'the collecting programming of the mind that distinguishes the member of one group or category of people from others' (Hofstede, Hofstede, & Minkov, 2010, p. 6). According to a recent revision of the theory, six dimensions are utilised to differentiate one culture from others: the power distance index, the individualism index, the masculinity index, the uncertainty-avoidance index, the long-term orientation index and the indulgence index. Figure 3 shows China's scores across the six dimensions, as provided by Hofstede Insights.

Figure 3: Chinese Culture According to Hofstede's Six-dimensional Model



Note. Hofstede Insight. (n.d.). China. Retrieved from https://www.hofstede-insights.com/country/china/, access on 15 November 2018.

Three dimensions are related to bank management in China and banks' relationship with government: power distance, individualism and long-term orientation. This section introduces these three dimensions and their observed management implications according to Hofstede et al. (2010).[7] A detailed discussion regarding bank management and government ownership, combining these dimensions, will be presented from the third section to the fifth section.

The power distance index is defined by Hofstede as ‘the extent to which the less powerful members of institutions and organisations within a country expect and accept that power is distributed unequally’ (Hofstede et al., 2010, p. 61). China’s high score on the power distance index indicates that the Chinese, to a large extent, accept inequality in society or in an organisation. Paternalism is quite acceptable, for example. A good leader in an organisation should be a ‘good father’ with prestige, whose ability and capacity are trusted and depended upon by subordinates. In addition, decision-making power may be centralised to leaders and superiors, and their subordinates expect to be informed of their responsibilities, to work within the organisation, and not to act beyond their rank.

The second dimension is the individualism index. As indicated by its low score on the individualism index, Chinese culture is quite collectivist. Collectivism is defined by Hofstede et al. (2010, p. 92) as ‘societies in which people from birth onward are integrated into strong, cohesive in-groups, which throughout people’s lifetime continue to protect them in exchange for unquestioning loyalty’. Hofstede et al. (2010) shows that, in a collectivist culture, in-group members are given priority when management makes hiring and promotion decisions. The relationship between employers and employees is similar to the relationship among family members. In addition, it is the trust in an individual person that makes the group that person belongs to trustworthy.

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[7] The masculinity index is related to individuals’ working attitude and gender equality in the workplace, the uncertainty-avoidance index is related to people’s attitude towards ambiguity, and the indulgence index evaluates to what extent people control their desire according to social norms (Hofstede, 2010). This does not mean these three dimensions are not relevant in understanding bank management in China. However, as this thesis focuses more on the relationship between government participation and management in banks, these three dimensions are comparatively less important here than the other three dimensions.

China has a high score on the long-term orientation index. Long-term orientation is defined as 'the fostering of virtues oriented towards future rewards – in particular, perseverance and thrift' Hofstede et al. (2010, p. 239). The values explored in the dimension have a direct connection with the East Asian tradition of Confucianism, which Hofstede and colleagues used to try to resolve the possible western bias of former indexes. Table 1 presents the essential characteristics of a long-term-oriented culture in the business field as discussed by Hofstede et al. (2010, p. 251).

Table 3: Key Characteristics of a Long-Term-oriented Society for Business

Main work values: honesty, adaptiveness, accountability and self-discipline
Leisure time considered unimportant
Focus on market position
Importance of profits 10 years from now
Owner-managers and workers have the same aspirations
Wide social and economic differences are undesirable
Investment in lifelong personal networks, guanxi

Note. Hofstede, G., Hofstede, G. J., & Minkov, M. (2010). *Cultures and organizations: Software of the mind; intercultural cooperation and its importance for survival (revised and expanded 3. ed.).* New York, NY [u.a.]: McGraw-Hill., p. 251.

Honesty, adaptiveness, accountability and self-discipline are work values cherished by employers and managers. Leisure time is not significant if there is a goal to achieve. The market position can be pursued at the price of short-term profit. Compared with profits made within the present year, managers place more emphasis on profits that will be made in 10 years. Instead of being psychologically separated into two different camps, managers and workers in long-term oriented cultures share the same aspirations. In addition, people in such a culture invest in life-long personal relations rather than changing their personal loyalties according to business needs.

3. Trust, Reputation and Bank Efficiency

Having summarized the literature, we can figure one of the most significant characteristics of the banks: compared with traditional manufacturing enterprises, the banking business depends, to a large extent, on trust and reputation, especially when we realise that there is a serious information asymmetry between depositors and banks and an endogenous and intentional bank run. When a bank functions as a liquidity provider or helps depositors with consumption smoothing, banks need trust from their depositors. A depositor who is willing to save a fixed-term deposit in a bank must believe that, with the given interest rate, he or she can withdraw the money when the deposit matures. A current deposit requires more trust, because depositors must believe that they can withdraw the money as soon as they need it and that banks can provide such liquidity all the time. Secondly, even though it has been theoretically shown that having banks as delegated monitors saves costs, the ability of banks in screening borrowers, in preventing borrowers' opportunistic behaviour and in punishing and auditing borrowers' default must be trusted by depositors.

For a private commercial bank, it is costly and time-consuming to win and sustain trust from customers and to build a reputation. Firstly, to persuade depositors that the bank can provide liquidity when depositors are in need, and to avoid liquidity risk, banks have to hold sufficient cash and cash equivalent, which do not generate a profit (Megginson, Ullah & Wei, 2014). The interest rate promised to depositors also requires a private commercial bank to exert itself in issuing and managing loans, which requires the bank to develop its capacity in risk management and in screening and monitoring its borrowers. Another factor that can be helpful in gaining the trust of individuals is the bank's ability to cope with both internal and external crisis. The cost can be extremely high, but if the bank survives the crisis, it gains not only a name and reputation but also experience and ability in managing crisis. Through the accumulation of trust from individuals, a private commercial bank can, ultimately, build a reputation that makes it easier for the bank to attract further deposits and issue further loans. In general, for private commercial banks, the process of accumulating trust and reputation is also a process of aggregating experience and capacities.

3.1. Government as a Reputation Provider

Since their establishment, China's 'Big Four' SOCBs have received the trust of depositors due to the authority of the government. Rationally, depositors believe that SOCBs will be rescued by the government during crisis, as this is what the government has done before: during the Asian financial crisis, it was the government that established the asset management firms that stripped off the non-performing loans of SOCBs. PBC also claimed that the long-lasting regulation of the interest rate was also applied to wait for the commercial banks' maturity in terms of interest rate decision ability (People's Daily Online, 2012b). Emotionally, people also believe that SOCBs are reliable and trustworthy. When we consider China's collectivist culture, the special role of China's government and the relationship between the government and the people, 'the state enjoys the status of an intimate and is treated like a member of the family, not just any member but the head of the family – the patriarch himself' (Jacques, 2012, p. 266). The emotional dependence of people on the government also encourages depositors to trust the SOCBs. Trust in the SOCBs, for either rational or emotional reasons, can greatly decrease the liquidity risk of SOCBs and alleviate the rooted bank run. For instance, during the 1997 Asian financial crisis, SOCBs were technically insolvent, but they were still liquid due to the confidence of that generation in the government. A recent study (Boateng et al., 2015) found that the liquidity of SOCBs is still better than that of non-SOCBs.

In comparison, JSCBs cannot directly enjoy the trust of depositors, like SOCBs. JSCBs, mostly owned by central-government-owned enterprises, can rarely share the depositors' trust in the government. Firstly, people will rationally hold the opinion that the collapse of a bank cannot be totally saved by an enterprise, even if the enterprise is owned by the central government. In addition, as the government also intervened much less in JSCBs, especially when JSCBs were faced with problems, the rational expectation of government intervention was greatly reduced. For instance, Hainan Development Bank, a JSCB, was the only bank to go bankrupt in China during the Asian financial crisis, when the government refused to bail it out (S. Zhang, 2012). Another example is that the proportion of non-performing loans in CMB rocketed to an average of 16.59% in 2000 (CMB, 2003, p. 6), also due to the Asian financial crisis, but the government did not provide any help. By 2004, CMB had decreased the proportion of non-performing loans to, on average, 2.91% through improvements in internal loan and risk management and by writing off the non-performing loans by profit (CMB, 2003, p. 19; 2004, p. 20; 2005, pp. 5, 25), without any help from the government. In addition, by long tradition in China, merchants have low social status and enjoy little reputation, so people are also emotionally unlikely to believe that an enterprise, such as a group of merchants, is as trustworthy as the government (Jacobs, Gao & Herbig, 1995, pp. 32, 33). For the JSCBs with local government shareholding, the authority of the government and customers' trust in the government may work to their advantage at the local level, but if the bank conducts business outside the city or the province, the association of the local government is not persuasive to depositors nationwide. For the two JSCBs owned by the private sector, to gain the trust and reputation of their customers is even more complex and difficult. For instance, part of the reason why PAB changed its former name Shenzhen Development Bank is that the brand name Ping An is more known nationwide than Shenzhen Development Bank and therefore can help the bank to expand business around the country (PAB, 2012). Compared with SOCBs, at the national level JSCBs must win the trust of depositors mainly by themselves.

3.2. Reputation and Bank Efficiency

However, reliance on the reputation and investment of the government can also impede the development of SOCBs: the easily achieved deposit scale can ultimately harm the motivation of SOCBs in terms of shifting and adapting their strategies to the market, and the reputation of the government will influence the client base of JSCBs and SOCBs, which in turn affects the efficiency improvement of the banks.

3.2.1. Given Reputation and Bank Strategy

CCB focuses on the construction sector and aims to maintain its relationship with infrastructure construction firms that are normally government owned in China. The bank emphasises its significance and advantages in the wholesale banking sector (CCB, n.d.b), but the proportion of profits before tax realised by the wholesale banking sector dropped from 52.16% in 2013 to 27.59% in 2017, while the profit earned by the wholesale banking sector decreased from 145.93 billion RMB in 2013 to 82.72 billion RMB in 2017 (CCB, 2014, p. 197; 2018, p. 214). At the same time, the proportion of non-performing loans generated by the wholesale banking sector increased from 1.42% in 2013 to 2.58% in 2017 (from 76.48 billion RMB to 166.04 billion RMB) (CCB, 2014, p. 30; 2018, p. 36). From 2013 to 2017, around 60% of the revenues were generated by city financial services, but ABC still focuses on the agricultural industry and emphasises its advantages in agricultural areas, especially in counties and towns (ABC, 2014, p. 33; 2016, p. 31; 2018, p. 31); ICBC focuses mainly on loan management and internal management improvement, but the proportion of non-performing loans increased from 0.94% in 2013 to 1.55% in 2017 (ICBC, 2014, p. 67; 2018, p. 50). BOC intends to expand worldwide, and it was the most successful bank in implementing its strategy among the ‘Big Four’ SOCBs from 2013 to 2017: the proportion of total profit generated before tax from outside mainland China increased from 19.38% to 29.86% (BOC, n.d.; 2014, p. 241; 2018, p. 232).

The four strategies of the SOCBs are in line with the fields assigned to them by the state; they were not actively selected in the beginning by the banks themselves, and the ‘Big Four’ SOCBs at that time also did not have their own competitive advantages in these fields except for the support from the government. Due to the reputation provided by the government and investment from the state, the ‘Big Four’ SOCBs were able to rapidly expand their business. However, the reputation provided by the government did not substantively accelerate capacity development inside the banks but accelerated the expansion of the SOCBs. The capacity aggregation progress of the SOCBs was incompatible with the deposit-and-loan-scale expansion of the banks; therefore, the ability of SOCBs to implement their strategies was limited. From 2010 to 2016, after the SOCBs all went public, the total assets of SOCBs increased from 46.89 trillion RMB to 86.60 trillion RMB (CBRC, 2017b, p. 204), while before 2015, the interest rate was restricted by the government, and banks could easily rely on the government decided interest rate difference to make money. SOCBs did not substantively cultivate their internal deposit and loan pricing ability. At the same time, banks increased the costs and investment in these fields, which made it increasingly difficult for banks to shift strategies due to sunk costs, even if the SOCBs ultimately found that their strategies were not profitable or far-sighted enough.

In comparison, without the government as a potential insurer and reputation provider, JSCBs need to earn their reputations by themselves. The successful JSCBs were those able to find their niche and differentiate themselves from other banks and to set their strategy by themselves according to the market situation. For instance, in 2004, CMB discovered that the retail banking sector was being ignored by other banks, and transferred its strategies to retail banking; as of 2017, the profit earned by the retail banking sector increased from 23.19 billion RMB in 2013 to 48.42 billion RMB in 2017, and it accounted for 56.83% of CMB’s profits before tax in 2017(CMB, 2014, p. 52; 2018, p. 37). In 2014, the bank decided to focus its strategy on financial technology and light banking (CMB, 2015, p. 7). After the global financial crisis, CMBC determined the difficulties small and micro businesses face in borrowing money, and then set its new strategy for small and micro business (CMBC, 2009, p. 21). IB was the most innovative bank in terms of interbank business, but under the pressure of regulation in 2017, IB redirected its strategy towards combining commercial banking services with investment banking services, while still enjoying its reputation for interbank business (IB, 2018, p. 6). In general, JSCBs that have found a niche and set a clear strategy adapt their strategies to market change, while the remaining old strategies still contribute to bank business. JSCBs that failed in clarifying their strategies are forced by the market to suffer from the decision and must adjust their strategies. For instance, the strategy of HXB has long been not clear and the conflict between the bank and the former strategic investor Deutsche Bank had not been solved. Finally, from 2013 to 2017, HXB's profit has been lowest among the eight JSCBs listed in mainland China, and Deutsche Bank also divested in 2016.

3.2.2. Bank Reputation, Customer Decision and Bank Efficiency

Another side effect of reliance on the reputation given by the government is that the name of the government influences customer decisions in selecting banks, especially the retail banking sector which has costly operating expenses. According to a report on the retail banking sector in China issued in 2014 by McKinsey & Co. (Lam, Shu & Huang, 2015, p. 5), the customers of SOCBs' retail banking sector did not embody any particular income, education or occupation characteristics, which means that SOCBs should take care of every kind of retail banking customers. In comparison, 65% of JSCBs' retail banking customers lived in the first-tier cities, 50% of JSCBs' retail banking customers range in age from 25 to 45 years old, and 70% of the JSCBs' retail banking customers have some form of higher education. For other kinds of commercial banks, the main client base of foreign banks was young, rich and better educated women; the wealthy old generation was the main client base for city commercial banks; and the rural commercial banks attracted mostly low-income and low-educated retail banking customers.

As retail banking customers of SOCBs did not display any particular characteristics, SOCBs were then expected to provide services to every kind of retail banking customer, including members of older generations with little banking knowledge. This older generation with little banking knowledge is possibly the most obsessed with the name of the government. Blind trust in the name of the government is less acute among the younger generation with little banking knowledge but with easier access to information using new technology, while members of the older generation with sufficient banking knowledge will make more rational decisions in selecting banks instead of acting only according to the name. Therefore, the greatest customer loyalty, especially retail banking customer loyalty, to the 'Big Four' SOCBs comes from the older generation with little banking knowledge. This group of customers can express a more conservative attitude towards technological developments such as online banking and mobile banking. If we consider the educational situation of this generation and their growth background, the high illiteracy rate can also obstruct the potential of the SOCBs in shifting user habits.[8] Therefore, to meet this group's needs, SOCBs have to maintain a sufficient number of outlets and employees to provide services to such customers, which creates costs for SOCBs in terms of redundant numbers of employees, and possibly in terms of maintenance of low-profit-generating outlets, all of which leads to the low efficiency of the SOCBs.

Figure 4 shows the proportion of employees working as bank tellers and marketing personnel in three SOCBs[9], and Figure 5 shows the number of branches of the SOCBs from 2014 to 2017, during which financial technology has boomed. Although the proportion of employees working as bank tellers and sales personnel and the number of the physical outlets of SOCBs have been

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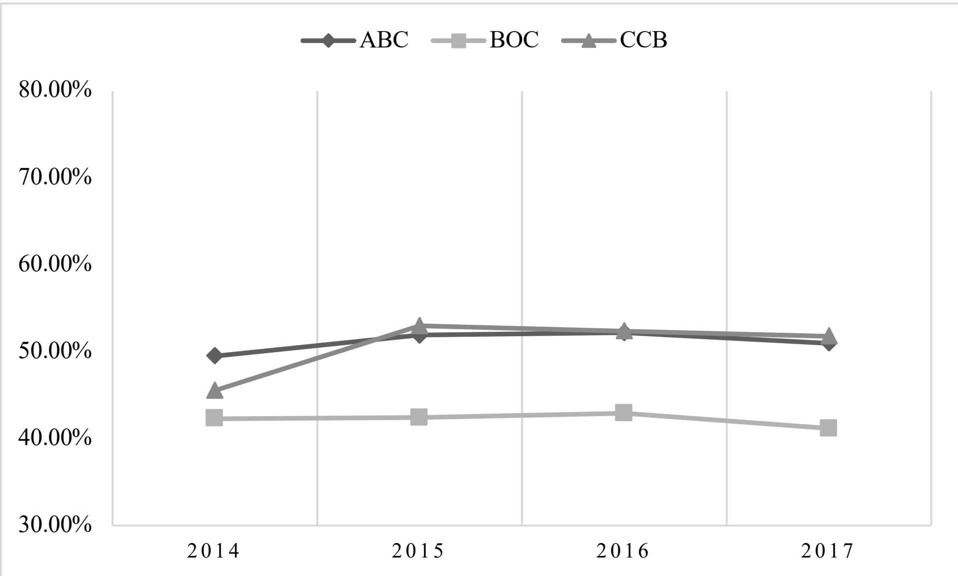
[8] According to United Nations Educational, Scientific and Cultural Organization, the literacy rate of among the population aged 65 years and older was around 73.91% in 2010, which means that the illiteracy rate among the population aged 65 was 26.09%: more than one fourth of the generation are illiterate (United Nations Educational, Scientific and Cultural Organization Institute for Statistics, n.d.).

[9] ICBC and BoCoM categorise their employees by a significantly different method. The proportion of ICBC employees as bank tellers and sales personnel is not clearly announced. BoCoM announced the proportion of employees working as bank tellers but does not give a clear definition to marketing development personnel. CCB announced the proportion of employees operating outlets and integrated bank tellers. Considering the main function of the outlets and the work of integrated bank tellers, we reasonably believe that it is the similar category of bank tellers and sales personnel in other two banks.

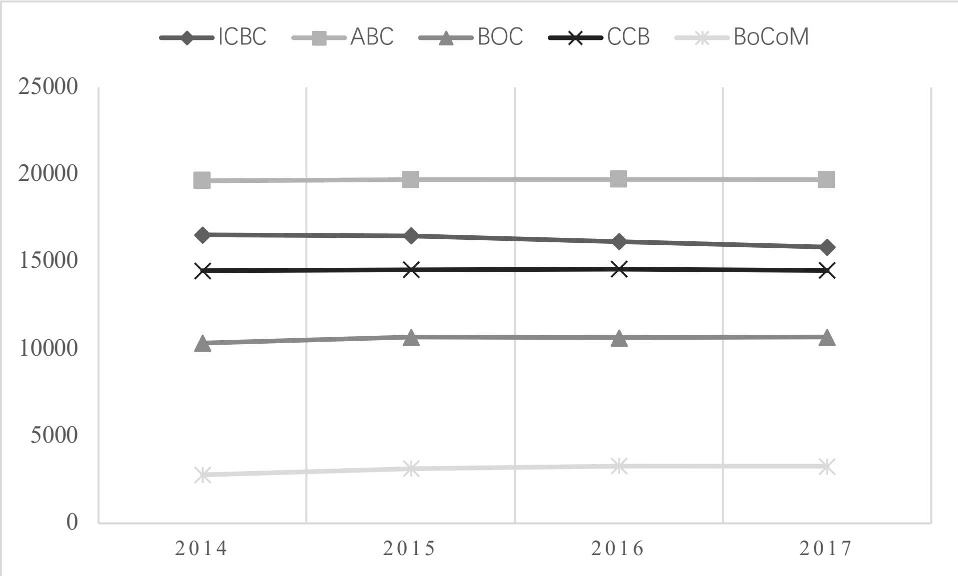
slowly decreasing, on average, the 'Big Four' SOCBs still ran more than 14,000 physical outlets in 2017 that provide most basic financial services such as cash saving, withdrawals, credit card and loan applications. There were, on average, 12 sales personnel and bank tellers working in each outlet in BOC, ABC and CCB in 2017.

Figure 4: Proportion of SOCB Employees Working as Bank Tellers and Sales Personnel from 2014 to 2017



Note. Data from ABC (2015, p. 71; 2016, p. 67; 2017a, p. 68; 2018a, p. 58), CCB (2015, p. 52; 2016, p. 53; 2017a, p. 53; 2018a, p. 58), BOC (2015, p. 72; 2016, p. 73; 2017, p. 73; 2018, p. 71)

Figure 5: The Number of SOCB Outlets from 2014 to 2017



Note. Data from ICBC (2015, p. 94; 2016, p. 94; 2017a, p. 91; 2018a, p. 89), ABC (2015, p. 72; 2016, p. 68; 2017a, p. 68; 2018a, p. 59), BOC (2015, p. 71; 2016, p. 75; 2017, p. 59; 2018a, p. 70), BoCoM (2015, 'COMPANY PROFILE'; 2016a, 'COMPANY PROFIL'; 2017, 'COMPANY PROFIL'; 2018, 'COMPANY PROFIL'), CCB (2015, p. 50; 2016, p. 49; 2017a, p. 47; 2018a, p. 52).

In contrast, as JSCBs from the beginning have not shared in the trust placed in the government, banks have had to find their niche and provide innovative deposit products and services to attract customers. For instance, in terms of deposit product innovations, CEB was the first bank to issue a wealth management product that offered a higher interest rate than the fixed-term deposit rate to attract customers (CEB, 2009, p. 30); in terms of retail banking services, CMB was the first bank to provide comprehensive debit card service and open online banking services to customers (CMB, n.d.). Through such innovations in retail banking services, JSCBs were able to attract more technologically inclined and younger customers. Attracting retail banking customers who are younger and better educated will bring several advantages for the management and efficiency of JSCBs. Firstly, these customers will have greater access to financial information through technology and communication that makes them more willing to engage in bank shopping, and JSCBs are usually not their only choice. Due to customers' bank shopping behaviour, JSCBs are forced to be sensitive to market change and to be ready for competition. A virtuous cycle starts: JSCBs release financial product innovations to attract younger and more rational customers who conduct bank shopping, and the bank shopping behaviour of the customers forces the JSCBs to further financial innovation and develop internal capacity and capability, which benefits the ability of JSCBs to attract younger and more rational customers, and so on. Additionally, as the age from 25 to 45 years old is the period when people accumulate wealth, if JSCBs are able to sustain their relationship with customers and successfully cultivate customer loyalty, Chinese households with a high saving rate[10] will become important deposit resources with increasing value. At the same time, households' mortgage and consumption loans will also become significant loan resources for JSCBs. Last but not least, as younger customers with better education have more access to technology and potentially more motivation to learn, it will be not difficult for JSCBs to take advantage of financial technologies and to shift retail banking customer habits, with the aim of decreasing the frequency of customers visiting the physical branches and outlets. Therefore, each branch is able to deal with more business and run more assets. In fact, the average asset run by each JSCB branch listed in mainland China was around 2.68 billion RMB, while the average for each branch of the five SOCBs was around 1.68 billion RMB.

3.2.3. Transferred Trust and Bank Efficiency

Bank employees can also take advantage of the given reputation of the SOCBs. Although a customer may choose to enter a bank because of the name of the government, the face-to-face communication and direct services are provided by bank employees, not by government officials. Especially for individuals and firms with high net worth, there is usually a fixed client representative offering consulting services and sustaining the relationship with the person in charge. As China has a long-term oriented culture, the relationship (or 'guanxi' in Chinese) established between the client managers and the customers is life-long oriented between the

[10] According to the International Monetary Fund. Asia and Pacific Dept (2017, p.7), Chinese households saved around 30% of their disposable income in 2016.

people but not between the bank and the customers. Through business and personal contact, trust in the abstract reputation conferred by the paternalistic government can be gradually transferred into trust in a concrete individual who contributes the wealth accumulation of the customer. If trust in the individual surpasses the SOCB's given reputation, then any job-hopping of a client representative of a SOCB will be accompanied by the departure of the customers he or she is in charge of. This is part of the reason why the JSCBs and city commercial banks are able to develop and expand their business while the market share of SOCBs has continued to shrink since 2006. During the process, the cost of establishing the relationships between people are left in the SOCBs, while the JSCBs pay the costs of sustaining the relationship and the comparatively high salary of employees.

4. Politician Bank Leaders

It is hard to assert that the interests of China's banks and the interests of the Chinese government are totally in conflict with each other. Part of the reason why China's government is able to stay in power and enjoy legitimacy is its ability to manage the economy and deliver growth (Jacques, 2012, p. 267). Profits and development of banks are also highly related to the prosperity of the economy. To some extent, the interests of the government and the interests of SOCBs are in line with each other. However, by appointing the leaders of commercial banks, the government is able to take advantage of the commercial banks to achieve its macro-level economic growth target, which implies that the efficiency of SOCBs and JSCBs can be sacrificed.

The most direct and obvious effect of direct government ownership participation in the SOCBs is that the central government has the right to appoint board directors and further has the right to appoint the senior managers of SOCBs, because SOCBs are supposed to implement corporate governance, while the government has at least 40% of the shares in SOCBs. In 2012, the

General Office of the Communist Party of China and the Organization Department of the Communist Party of China issued two documents with regard to rules and assessment criteria for senior managers, supervisors and directors who work for financial institutions under the control of the central government. According to the official news, cultivation, selection, appointment, salary and regulation of the senior managers, supervisors and directors are all included (People's Daily Online, 2012a).

The result is that the experience of some directors, supervisors and senior managers in SOCBs and JSCBs is more in the field of politics than financial business. For instance, Liange Liu was appointed vice chairman and president of BOC in 2018. Before this, however, he had never worked for BOC, in a commercial bank or even in a profit-oriented financial institution. He had worked in the Export-Import Bank of China that was set up by the government to serve foreign trade without a profit-earning target, and earlier worked for PBC, which is China's central bank under the control of the State Council (BOC, n.d.c). Similar bank leaders can be found in all SOCBs and in JSCBs with local government background. These kinds of managers, supervisors and directors are appointed by the state as representatives of government, and they are expected to represent the interest of the government. In addition, not only can officers with a financial background be promoted to bank leaders in SOCBs, but leaders in SOCBs can obtain appointments in the political arena. For instance, Yi Kang, the former vice president of ABC, was appointed vice-mayor of Tianjin (Tianjin Municipal People's Government, n.d.).

4.1. Bank Leaders, Economic Growth and Bank Efficiency

The interests of bank leaders with a political background[11] are in conflict with those of the SOCBs, and it would be difficult to adapt their interests to those of stakeholders, because the ambition of politician bank leaders is not for a banking business career but a political career.

In China, the power to promote a government officer is centralised to the higher-level government, and the government sets rules about such promotion. One rule of evaluation regarding how political leaders are promoted is tightly related to their contribution to economic growth during their term of office, and the compatibility of the official's abilities with their future working area (People's Daily Online, 2014). In other words, if a politician bank leader wants to achieve promotion in the government, instead of working towards improving internal bank management, profitability and efficiency, they will tend to pursue visible results directly related to political achievement: participating in the government-led programmes bringing about economic growth. During the process, SOCBs with sufficient numbers of national and international branches and with abundant savings are utilised as liquidity providers to programmes planned and supported by the government. At the same time, because China is highly tolerant of power at a distance and the governance structure of SOCBs is highly hierarchical, once bank leaders reach a consensus, their decisions have almost the weight of orders to the subordinate institutions and branches. According to social responsibility reports issued by SOCBs, a large number of loans and services is provided to infrastructure construction programmes as one of the representatives of their contributions to society. In addition, the loan and service participation in such programmes is highly responsive to the government's plans and policies. For instance, the Belt and Road Initiative was announced in 2013, and from 2014, the 'Big Four' SOCBs have continued to publicise the liquidity support

[11] We will refer to such individuals as politician bank leaders.

they have offered to the programme. As shown by its 2014 social responsibility report, BOC has participated in Belt and Road Initiative, and by 2017 the bank had provided around US $100 billion (around 670 billion RMB) in credit to the countries and enterprises along the route. This amount of credit accounts for around 6.29% of the total loans issued by BOC in 2017 (BOC, 2018b, p. 14), but if we compare it to the loans issued by CMB (the largest JSCBs) and Bank of Beijing (the largest city commercial bank) in 2017, it would account for 18.79% of CMB's issued loans and 64.48% of the total loans of the Bank of Beijing. This scale of loans may threaten the safety of the banks. The large scale of the loans of government-led programmes, to some extent, set a threshold to enter the financing activities of such large-scale programmes. Although the SOCBs face competition from each other, the competition for the government-led programmes, especially for the national and international programmes, is far less fierce. SOCBs can easily rely on the scale to earn interest, but this impedes their ability to explore loan innovations.

Similarly, JSCBs are also faced with the distorted interest of bank leaders, especially the JSCBs with a central-government-owned enterprise background and with a local government background. For the four banks majority owned by central-government-owned enterprises (CMB, CGB, CITIC and CEB), although the ownership participation of the central government is indirect in the bank, the politician leaders are present in the parent enterprises, and due to the special role of banks as financial intermediaries, they can be utilised as a tool to achieve the political goals of the parent enterprise leaders. Such JSCBs also actively participate in the Belt and Road Initiative and declare how many loans they have issued to the programmes as part of their social responsibility. For instance, CMB issued 2 billion RMB worth of loans to the construction programmes of COSCO Shipping Group in 2017 to support the Belt and Road Initiative, and the loan application was approved within seven working days (CMB, 2018b, p. 59). For the remaining six banks that are partially owned by local government or by the local government's investment platform, although the local government does not have the majority share in these banks, the politician bank leaders within the banks will also influence the decision-making of JSCBs. As the Chinese government continues to enjoy its patriarch status, the decision-making power structure within the bank does not necessarily match the ownership structure: the politician bank leaders may have more power than they should and could exert a greater influence on the bank's decision. Sometimes, loans are specially issued to support local construction plans. For instance, by the end of 2017, HXB had provided 30 billion RMB in total to state-owned heavy industry firms in Beijing, in order to support the relocation of heavy industry as a part of the economic integration plan of the Beijing-Tianjin-Hebei region initiated by the government at the beginning of 2014 (HXB, 2018b, p. 26).

However, whether the interest rate for loans and price for services provided to these kinds of programmes comply with the market interest rate is questionable. Firstly, China's interest rate was only recently liberalised. The long-existing float range limited the possibility of banks in setting interest rates according to market change (He, H. Wang & Yu, 2015, p. 259). At the beginning, it was only that banks were not allowed to change their interest rate based on the market situation, but for such a long term, the ceilings on deposit interest rate root in the whole interest rate pricing system. Because Chinese banks rely on deposit to fund themselves, the deposit ceilings finally influence the interest rate pricing ability of commercial banks (He & H. Wang, 2012). After the interest rate liberalization, it will take a long time for banks to cultivate their internal capacity to a point where it can figure out a suitable interest rate for loans. At the present stage, it will be difficult for SOCBs to differentiate themselves from others through interest innovation when participating in the government-led programmes. The most direct and convenient method to win over the other banks is either to decrease the interest rate or to provide enough loan scale. In addition, corporations undertaking research and construction responsibilities in government-led programmes are usually state-owned enterprises. For example, all of the corporations participating in construction related to the Belt and Road Initiative are central-government-owned enterprises that are most possibly facing soft budget constraints (Belt and Road Portal, 2016). This would further influence the loan-issuing decisions of banks. Banks will expect that, if the corporations are unable to pay back the loans, the government will take over the responsibility to pay the debt. As the government plays the role of implicit guarantor, banks would believe that loans issued to the state-owned enterprises are less risky, and accordingly set a lower interest rate for these corporations.[12] In fact, according to a report issued by Chinese Academy of Fiscal Sciences, from 2014 to 2016, the weighted loan interest rate for state-owned enterprises was 1.5% lower than that for private firms (Ma, 2017). It is argued that the existence of banks decreases the transaction cost and monitoring cost of depositors; however, when banks, due to the political interests of politician bank managers, relax their monitoring standards and decrease the interest rate, the moral hazard problem between depositors and banks can be more serious than expected.

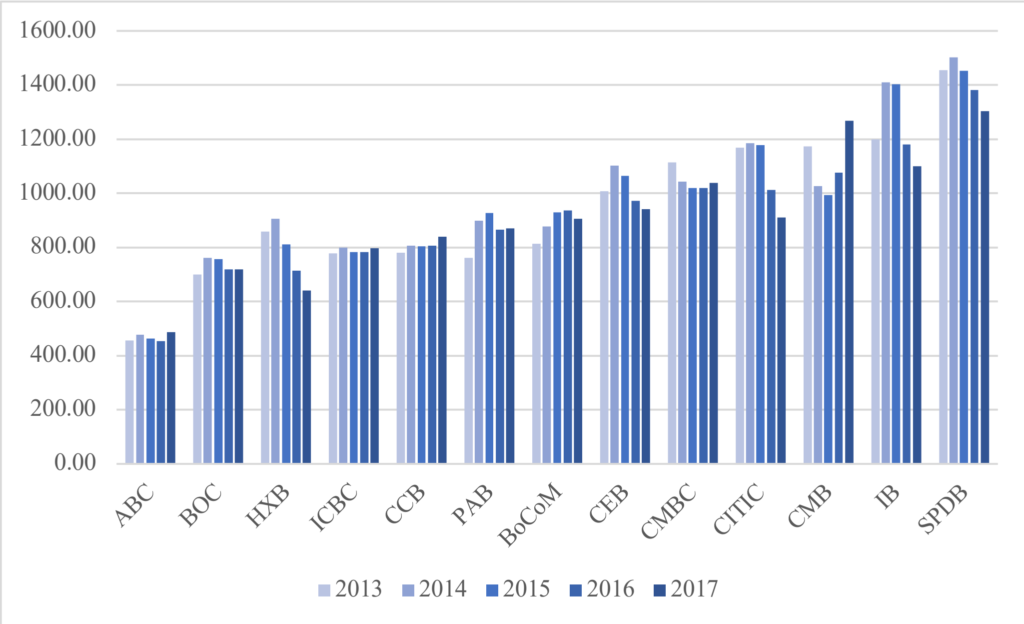
4.2. Politician Bank Leaders, Social Stability and Bank Efficiency

Apart from economic growth, social stability and harmony are also important in terms of the political results of Chinese politicians, especially when we consider that China is a one-party state. Either the Communist Party of China tends to reinforce its legitimacy through economic growth or to grasp the power as long as possible, a stable social environment is necessary. However, when the politician bank leaders pursue social stability and harmony, the efficiency of SOCBs will also be influenced. The first effect is that SOCBs are unwilling to fire unnecessary staff and to close redundant branches and outlets. Figure 6 shows the profit earned by per employee (in thousand RMB) of SOCBs and JSCBs listed in mainland China from 2013 to 2017. The profit per employee of the SOCBs has not been high enough and has been quite stable during the period, especially compared with other listed JSCBs. Figure 7 shows the

[12] A similar story involves Moody's rating a bond issued by a subsidiary of China Railway Group Ltd.. In 2017, Moody's gave an A3 to bonds issued by China Railway Group Ltd., which claims that the rating of China Railway Group Ltd. is Baa3 but taking the potential support from the government into consideration, Moody's rated the bonds as A3 (Moody's, 2017).

number of employees in SOCBs from 2013 to 2017, and figure 8 shows the number of employees in JSCBs listed in mainland China during the same period. It is demonstrated that, even though the profit before tax earned by each employee of SOCBs continued to be low during the period, the SOCBs rarely downsized. In addition, the number of the employees in SOCBs was more stable than that in JSCBs: either increases or decreases, it changes more dramatically than SOCBs. In addition, for JSCBs, more employees did not necessarily mean lowered profit earned by each employee, while downsizing can usually bring about the increase in the profit earned by each employee. For instance, from 2016 to 2017, the number of employees in CMB increased from 70,461 to 72,530, and, simultaneously, the profit per employee of CMB also increased from 1.08 million RMB to 1.27 million RMB. Another example is PAB from 2016 to 2017. The profit earned by per employee of PAB decreased from 928,136 RMB in 2015 to 865,373 RMB in 2016. Furthermore, at the end of 2017, the number of PAB employees had decreased by 4,383, around 11.88% of the number of employees in PAB in 2016, and the profit per employee increased to around 869,241 RMB in 2017.

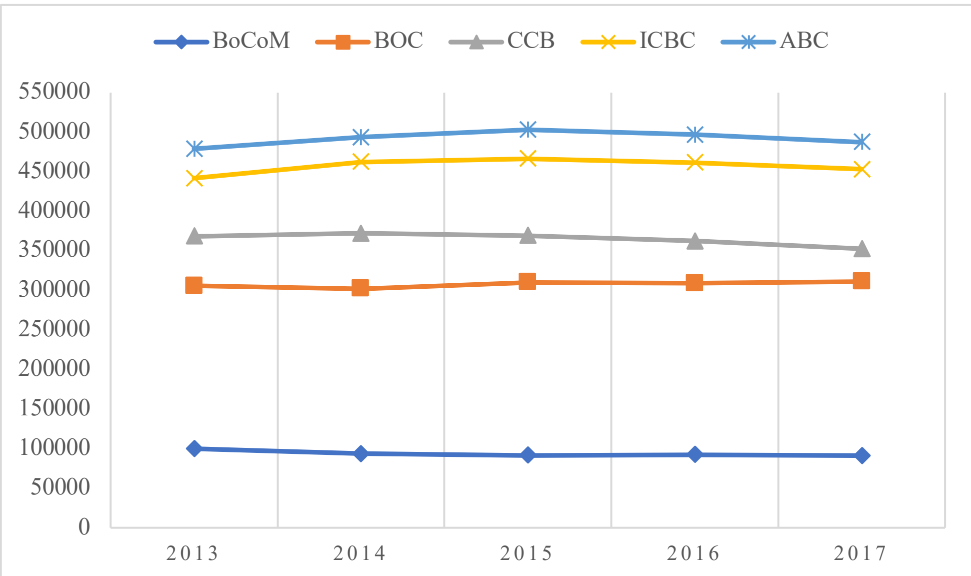
Figure 6: Profit per Employee of SOCBs and JSCBs Listed in Mainland China from 2013 to 2017 (in Thousand RMB)



Note. Profit per employee $= \frac{2*\text{profit before tax at the end of the year}}{(\text{the number of employees at the end of the earlier year}+\text{the number of employees at the end of the year})}$

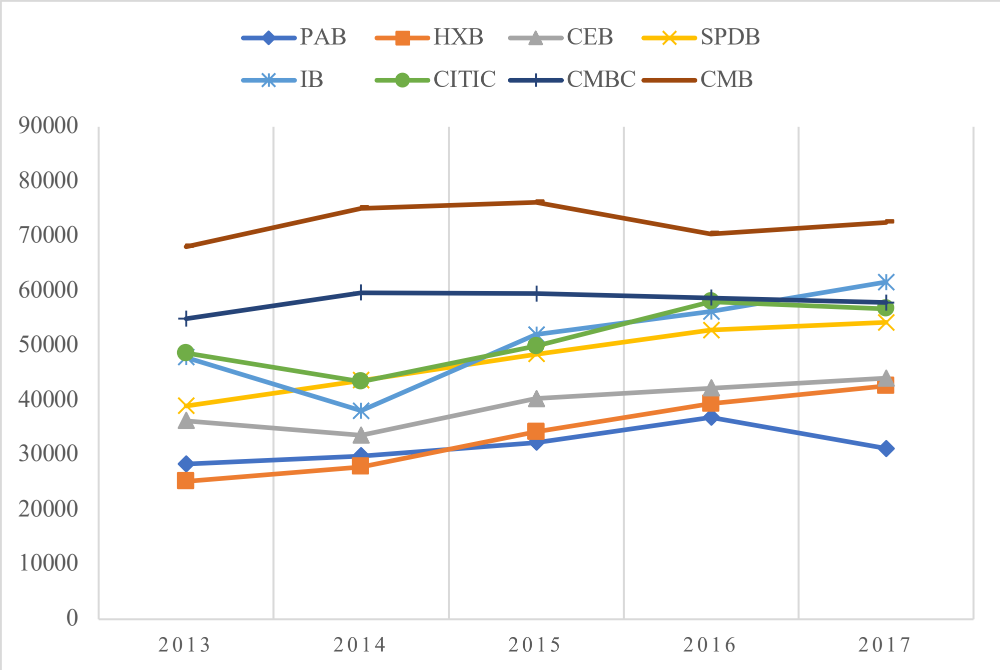
Data source: Wind.

Figure 7: The Number of Employees in SOCBs



Note. Data source: Wind.

Figure 8: The Number of Employees in JSCBs Listed in Mainland China



Note. Data source: Wind.

Under the pressure of competition from financial technologies and other banks, if SOCBs do not downsize according to market change, they will have to either decrease the salary of employees or increase the capacity of each employee to adapt to market variation. SOCBs have done both. The average salary of SOCBs is much lower than that of JSCBs,[13] while SOCBs also set a high entry requirement for new employees. For example, in the 2019 spring recruitment season for students, CCB and ABC required that, for an entry-level job, one should have at least a bachelor's degree in the area of informatics or law and be fluent in English (ABC Beijing Branch, 2019; CCB Beijing Branch, 2019); BOC requires that, in addition to fluent English and a bachelor's degree in economics, finance, informatics or mathematics, candidates must demonstrate communication skills and the ability to work as part of a team (BOC, 2019). In addition to the standard requirements, BoCoM takes applicants' grades during study into consideration (BoCoM, 2019). In general, the qualification requirements are not lower than those of the banking industry (Bloomberg, 2018). However, SOCBs that have recruited

[13] Table 4 shows the average salary, including welfare and pension payment, of SOCBs and JSCBs listed in mainland China from 2013 to 2017.

employees with lower level salaries will be faced with the following problems. Firstly, some of the new employees are not as qualified as those who have joined the JSCBs, due to the reduced salary; secondly, the new employees with the same qualifications are less motivated than their colleagues in JSCBs because of the expected job stability in SOCBs; thirdly, the motivated new employees with good qualifications use their work in SOCBs as a springboard for a future career, in finance or politics. This behaviour makes the SOCBs less efficient than JSCBs, and even those who are motivated and qualified need training at the beginning of their career to adapt them to the industry, which is both costly and time consuming. Once they transfer to other financial institutions due to an expected higher salary in other financial institutions, before having generated equivalent-value-for-training to SOCBs, the initial training cost is left within the SOCBs. When SOCBs must recruit new employees, they have to pay the training costs again.

Table 4: Average Emoluments including Welfare and Pension Payment to Employees in China's Listed SOCBs and JSCBs 2013 to 2017 (in Thousand RMB)

	2013	**2014**	**2015**	**2016**	**2017**
SOCBs					
ICBC	234.11	242.32	244.82	245.49	253.73
ABC	218.58	225.87	219.38	224.54	233.49
BOC	238.04	257.96	259.03	261.55	263.98
CCB	236.22	247.08	248.08	258.59	273.21
BoCoM	225.06	263.51	277.99	281.86	306.03
Average salary	**230.40**	**247.35**	**249.86**	**254.41**	**266.09**
JSCBs					
PAB	381.05	472.97	472.49	344.31	485.17
SPDB	405.43	396.44	397.36	413.59	433.02
HXB	353.40	396.26	364.92	336.94	286.04
CMBC	348.55	375.92	404.54	427.15	433.97
CMB	371.32	403.13	355.60	465.66	489.62
IB	361.70	453.87	383.32	401.59	385.95
CEB	331.85	412.37	353.88	254.53	349.32
CITIC	366.00	487.24	372.89	421.94	485.14
Average salary	**364.91**	**424.78**	**388.13**	**383.21**	**418.53**

Note: 1) Average Emoluments = $\frac{\text{Accrued staff cost at the yar end} - \text{accrued staff cost at the end of former year} + \text{staff costs}}{\text{total number of employees at the year end}}$

2) Data from Wind Economic Database.

Another effect of the interest of the politician bank leaders in sustaining social stability is that banks will be utilised as a channel for redistribution, which should be the responsibility of the government. For instance, the central government decreed that the country should take targeted measures towards poverty alleviation, and from 2015, the SOCBs have continued to disclose how much in loans they have issued to certain programmes related to poverty alleviation. Providing loans to such programmes becomes a political action instead of the financial and business target of the SOCBs. For instance, since the policy was initiated in 2015, the loans issued by CCB focusing on poverty alleviation increased from 77.50 billion RMB to 149.26 billion RMB in 2017 (CCB, 2017b, p. 47; 2018b, p. 51). The loans issued by ABC targeted at poverty alleviation increased by 335.1 billion RMB in 2016, and by the end of 2017, its remaining loans for poverty alleviation amounted to 815.07 billion RMB (ABC, 2017b, p. 61;

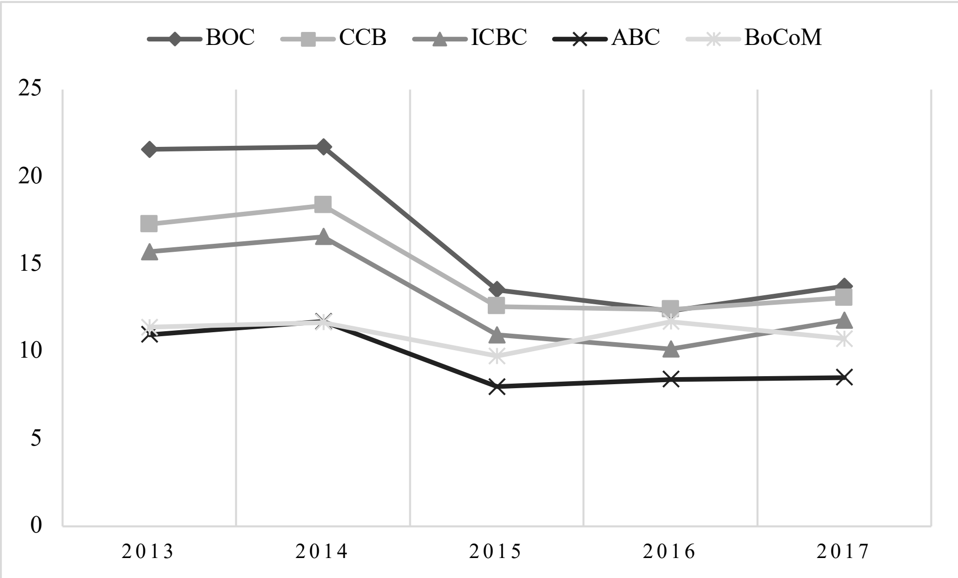
2018b, p. 53). Similarly, the total amount in loans issued by ICBC to support poverty alleviation was 93.01 billion RMB at the end of 2016; one year later, its loans issued for poverty alleviation had increased to 127.03 billion RMB (ICBC, 2017b, p. 77; 2018b, p. 89).

Taking part in the redistribution programmes is not limited to SOCBs; JSCBs are also required by the regulation institutions to take some responsibility for redistribution. In 2016, PBC issued the Implementation Opinions of the People's Bank of China, the National Development and Reform Commission and the Ministry of Finance on Finance-Helped Poverty Relief, which require financial institutions to take targeted measures towards poverty alleviation (PBC, 2016). In 2016, all JSCBs started to search for poor areas in which to provide financial support. For instance, in 2016, CGB selected a destitute town and, after conducting research and establishing an archive, created a three-year poverty alleviation plan and invested an initial 1.15 million RMB in the county (CGB, 2017, p. 66). In 2016, PAB invested 500 million RMB to support a livestock farming programme to alleviate poverty in the relevant towns (PAB, 2017, p. 72). The implementation opinions issued by the PBC became the regulation for commercial banks, with the result that, even though there are no politician bank leaders in a commercial bank, banks still have to participate in redistribution programmes. Banks increase the amount of loan resources and human resources invested in the poverty alleviation programmes and set a favourable loan price. However, because resources flow to the programmes due to government policy rather than market choice, their sustainability of the programmes is questionable. It is possible that, once the policy changes, the programmes will collapse. The invested loans and human resources would remain in banks as waste.

5. Remunerations of Key Management Personnel

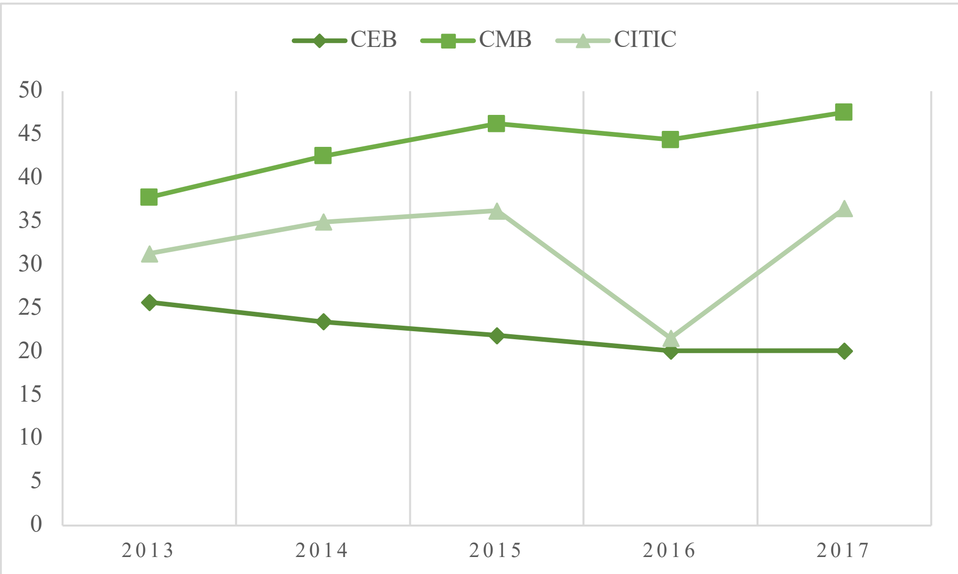
Another effect of majority ownership participation of the central government is that the salary of bank leaders is stipulated by the central government, from which JSCBs are exempt. In 2010, the Ministry of Finance issued a notice regarding the salary and potential welfare censorship of state-owned financial institutions, and then the CBRC issued its Supervisory Guidelines on Sound Compensation in Commercial Banks (CBRC, 2010). The most recent change in salary requirements was in 2014, and they came into effect in 2015 (F. Wang, 2017). Figure 9 shows the change in total bank leaders' remunerations in SOCBs from 2013 to 2017 due to the regulation on salaries in central-government-controlled corporations: the total remunerations paid for bank managers in SOCBs significantly decreased from 2013 to 2015. Although there existed a slight increase from 2015 to 2017, the salary of senior managers was still much lower than before the salary restriction. Figure 10 to 12 show the change of the remuneration to the key management personnel in the three types of JSCBs. We can clearly figure out that the remuneration to directors, supervisors and senior managers of JSCBs with local government background expressed the changing tendency similar to that of SOCBs. The remunerations to the key management personnel of other two types of JSCBs did not show similar trend. In addition, either before or after the salary regulation, the remunerations to key management personnel in SOCBs were much lower than that of JSCBs.

Figure 9: Total Remunerations to Directors, Supervisors and Senior Managers of SOCBs from 2013 to 2017 (in Million RMB)



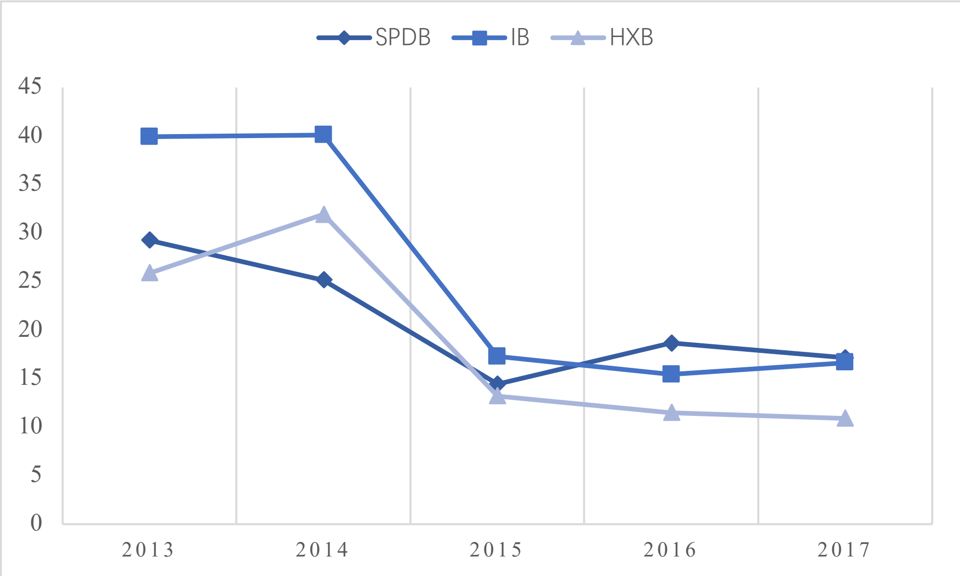
Note. Data from BOC (2014, p. 84; 2015, p. 90; 2016, p. 88; 2017, p. 86; 2018a, p. 85), CCB (2014, pp. 148, 205; 2015, pp. 148, 212; 2016, pp. 156, 221; 2017a, p. 158, 210; 2018a, pp.170, 222); ICBC (2014, pp. 184, 230; 2015, pp.164, 211; 2016, pp. 165, 216; 2017a, pp. 168, 219; 2018a, pp. 167, 220), ABC (2014, p. 208; 2015, p. 132; 2016, p. 132; 2017a, p. 133; 2018a, p. 108), BoCoM (2014, p. 241; 2015, p. 262; 2016a, p. 254; 2017, p. 267; 2018, p. 239)

Figure 10: Total Remunerations to Directors, Supervisors and Senior Managers of JSCBs with State-owned Enterprise Holdings from 2013 to 2017 (in Million RMB)



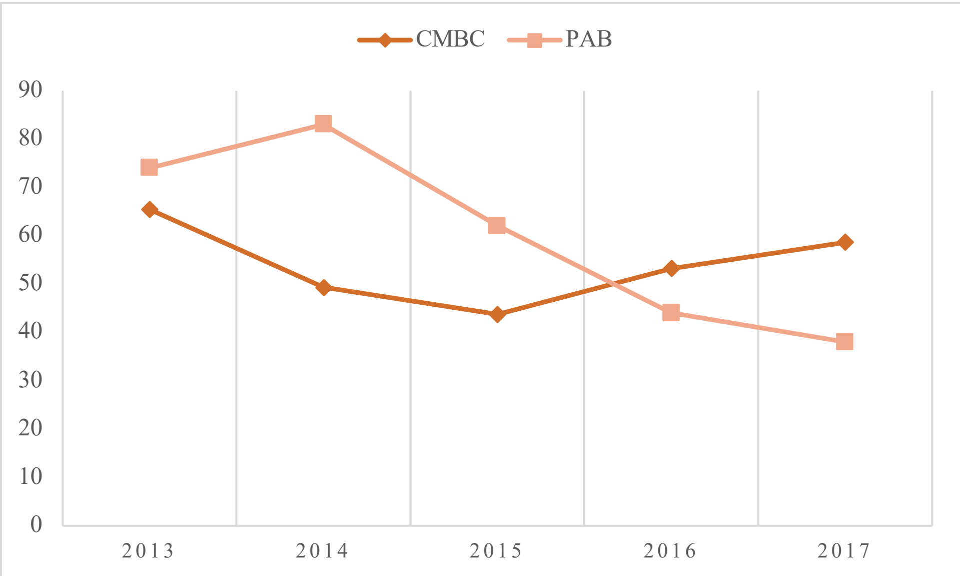
Note. Data from CEB (2014, p. 204; 2015, p. 220; 2016, p. 217; 2017, p. 229; 2018, p. 233); CITIC (2014, p. 125; 2015, p. 119; 2016, p. 113; 2017, p. 125; 2018, p. 126); CMB (2014, p. 320; 2015, p. 314; 2016, p. 296; 2017, p. 310; 2018, p. 268)

Figure 11: Total Remunerations to Directors, Supervisors and Senior Managers of JSCBs with Local Government Holdings from 2013 to 2017 (in Million RMB)



Note. Data from SPDB (2014, pp. 79, 80; 2016, p. ; 2017, pp. 231; 2018, p. 121); HXB (2014, p. 74; 2015, p. 74; 2016, p.81; 2017, p. 97; 2018, p. 82); IB (2014, p. 83; 2015, p. 97; 2016, p. 98; 2017, p. 101; 2018, p. 95)

Figure 12: Total Remunerations to Directors, Supervisors and Senior Managers of JSCBs without Government Background from 2013 to 2017 (in Million RMB)



Note. Data from PAB (2014, p. 231; 2015, p. 207; 2016, p. 194; 2017a, p. 248; 2018, p. 207); CMBC (2014, p. 104; 2015, pp. 106, 107; 2016, pp. 108, 109; 2017, p. 119; 2018, p. 130)

The non-market-decided salary has several effects. Firstly, managers paying more attention to the financial return for their efforts will find that the decreased financial return is not worth the effort they have made and the risk they have taken to achieve promotion, which could lead them to withdraw from competition of promotion in SOCBs. Also, those who are more obsessed with political power will be competitive and strive for promotion, and at last, the motivation of the bank employees was to achieve their personal political goals. As China is highly tolerant of power distance and collectivist, the function of bank managers is significant, which will influence the management and efficiency of SOCBs.

There are two main ways for managers to withdraw from competition in SOCBs. The most direct one is to transfer to a competitor that promises a higher salary. The inadvertent decrease in salary is one of the reasons for the resignation wave in SOCBs in 2015. Five senior managers of BOC resigned in 2015, including Waikin Chim, who had worked in various foreign banks, and was employed as chief credit officer by BOC from 2007 based on a market-decided salary (BOC, 2015, pp. 90, 102; 2016, p. 88). ABC, CCB, BoCoM and ICBC each lost at least two senior managers. The senior managers moved into JSBCs, central government-controlled enterprises or private firms, or embarked on political careers (Indaa Finance, 2015; ICBC, 2016, p. 93; CMBC, 2016, p. 211; CCB, 2016, p. 76; China Securities Regulatory Commission, n.d.; ABC, 2016, p. 97; Bloomberg, 2016; BoCoM, 2016, p. 117). Apart from the senior managers whose departure was announced by the annual reports, several middle-level managers also left SOCBs. For instance, the Suzhou sub-branch manager of BOC resigned, and then became the president of Huarui Bank, one of the first five domestic private banks, established in 2015 (Indaa Finance, 2015). The departure of these managers will have several effects on SOCB management. Firstly, managers aggregated the resources in SOCBs during their time in office, including not only visible resources such as wealth and status, but also management experiences, political resources and relationships with other managers, with customers and with bank employees. As mentioned above, Chinese culture has a long-term orientation that emphasises life-long personal relationships, and is highly collectivist with an emphasis on in-group loyalty, so the departure of the managers will bring about not only a loss of the resources formerly in those managers' hands, but also the loss of resources in the hands of the in-group members. When managers leave a bank, they remove a large amount of the bank's resources and leave large costs in their place. This directly decreases the personnel reserve in SOCBs. On average, there were around 339,070 employees in SOCBs according to the annual reports of SOCBs in 2017,[14] which means that all employees seeking promotion are faced with fierce competition. What is more, according to the CBRC regulations, all managers of banks must have abundant management experience in a financial area, nationwide or worldwide admitted certifications, and sometimes must be fluent in at least one foreign language (CBRC, 2013). Although there still exists a possibility for corruption and bribery during the promotion process due to the hierarchical and bureaucratic governance structure of SOCBs, in general, managers must possess ambitions, abilities, experience and resources that give them an advantage over their competitors within the bank. Therefore, managers of SOCBs have been, to some extent, winners in the fierce competition within the bank. The departure of SOCB managers is equal to the loss of ambitious and competent talents of SOCBs.

The high salary in JSCBs makes it possible for them to attract senior managers from SOCBs. The current president of CMB was the chief executive officer of the retail banking sector of CCB, and he moved to CMB in 2013, when the annual salary for senior managers at his level was 912,000 RMB at CCB and 3.16 million RMB at CMB (CMB, 2013, p. 109; CCB, CCB, 2013, p. 89).

[14] The average number of employees in SOCBs in 2015 was around 348,020. Because BoCoM is much smaller in scale than the 'Big Four' SOCBs, the number of BoCoM's employees is also much less. The average number of employees in each of the 'Big Four' SOCBs was around 412,160 in 2015 and 401,030 in 2017.

A second way for managers to withdraw from competition in SOCBs is to be satisfied with the status quo. The limitation of salary directly decreases managers' personal financial return from taking part in the competition for promotion to a higher management level or in a risky internal reform. More risk-averse managers focusing on their individual income and status only guarantee that they will not make mistakes and only satisfy performance indicators, instead of exploring external resources and improving internal management. As the SOCBs are now faced with competition not only from other SOCBs, JSCBs and city commercial banks but also from developing private banks and financial technologies, any resources not explored by inactive internal managers will be sought and explored by other competitors. Once SOCBs lose the first-mover advantage, it will be difficult to exploit the value of new financial products. For instance, the threat from financial technology in China is increasingly fierce. According to a social responsibility report on the China payment industry, the scale of mobile payment in China increased from 2.49 trillion RMB in 2012 to 308.04 trillion RMB in 2018 (Payment and Clearing Association of China, 2018, p. 13). The settlement business is challenged by the new financial technology. In addition, in 2013, Alipay cooperated with Tianhong Fund to launch Yu'E Bao, a money market fund product with a T+0 redemption period and a 2.31% seven-day annualized rate of return (Tianhong Asset Management, n.d.). As Alipay is one of the two largest mobile payment players in China, a number of users utilise Yu'E Bao as a substitute for current deposit. Although Yuebao later became heavily regulated, the net value of the fund nevertheless increased within five years to 1.31 trillion RMB by the end of 2018 (Tianhong Asset Management, 2018, p. 16). Although banks later cooperated with other money market funds, introducing similar products, few have achieved a comparable scale. The passivity of managers due to the decreased salary within SOCBs will lead to a vicious cycle: inactive managers are not motivated to explore and to exploit resources, which leads to decreased bank profitability and efficiency; efficiency and profitability will continue to decrease until the income of managers further decreases and the circle is perpetuated. In addition, the decreased salary will further influence internal reform of SOCBs; especially after 2015, there has been a new signal towards further privatisation. The reform of SOCBs, especially the further privatisation reform, faces not only business risks but also political and legal risks. For instance, BoCoM's reform plan, proposed in 2015, included introducing private capital and achieving an employee stock ownership plan; but the National Development and Reform Commission also clearly figured out the potential corruption including the erosion of private capital on state-owned assets and tunnelling among vested interest groups through further privatisation (L. Zhang, 2017). The decreased salary leads managers either to try designing more sophisticated and subtle reform plans to achieve their own private financial goals or to be less active in the reform to avoid suspicion. In fact, during the last three years, although there were reforms in terms of introducing private capital in BoCoM's subsidiary corporations, there was no further substantial progress towards privatisation in BoCoM.

The politician bank leaders, as mentioned above, are detrimental to bank efficiency. However, when individuals competing for financial gains withdraw from the internal competition, the proportion of lower-level bank managers and employees striving for political power instead of financial gains greatly increases. More bank resources will be sacrificed not only to nationally driven programmes but also to regionally driven programmes to achieve the political goals of the government rather than the financial and efficiency targets of SOCBs. In comparison, as JSCBs are allowed to set a market-decided salary, the salary of senior managers acts as the effort target and provides a concrete and clarified incentive factor.

Conclusion

It is important to understand the significance of China's government and the role of Chinese culture in the banking sector, particularly as regards banking privatisation and efficiency and management of China's banks. The analysis presented in this master's thesis provided an overview of the role of the government in China's banking industry and elucidated how the ownership participation of government, alongside Chinese culture, influences the efficiency of China's banks. In the process, conclusions were reached that will be beneficial to expand upon the existing literature and to improve the understanding of the relationship between China's government and the commercial banks.

The first section introduced China's banking industry, significant commercial banks and regulatory institutions. Having reviewed the reform and ownership structure of SOCBs and JSCBs, we reached the conclusion that China's government directly or indirectly partially owns China's most significant commercial banks: SOCBs are not wholly owned by the government, while JSCBs are also not wholly owned by the private sector. At the same time, PBC and CBRC, as regulatory institutions, are making the regulatory more market-oriented and more open, also affecting the management of SOCBs.

The next step was to review the existing literature with regard to privatisation, partial privatisation, characteristics of banks, bank privatisation, the efficiency of China's banks and Chinese culture based on Hofstede's six-dimensional model. In conclusion, in explaining bank efficiency in China, several issues are ignored by the literature and some other factors need to be taken into consideration. Primarily, banks, as financial intermediations, are not the same as traditional manufacturing enterprises, their privatisation needs further discussion. In addition, there is always a shadow of government behind the China's major commercial banks, although banks express different efficiency performance levels. There is insufficient discussion about why such differences exist. In addition, the partially privatised banks are faced with competition from other types of banks, from banks of the same type, from foreign banks and from potential new players, which is quite different from the duopoly market form described in the partial privatisation literature. Last but not least, Chinese culture is tolerant of power distance, long-term oriented and collectivist. Among the six dimensions of the Hofstede model, these three are the most significant dimensions that will influence the relationship between China's government and its commercial banks.

Following the literature review, the analysis of how the government ownership participation in the banks influences banking management and efficiency began in the third section. We discussed how China's different types of government ownership participation in commercial banks influences the reputation of SOCBs and JSCBs, and then how reputation in turn affects the efficiency of SOCBs and JSCBs. China's government, regarded as the patriarch in this collectivist country, shares its trust and reputation (bestowed by the Chinese people) with SOCBs through its direct ownership in SOCBs, which helps SOCBs in attracting depositors. However, the provided reputation also impedes improving the efficiency of SOCBs. The incompatibility between the reputation of the SOCBs and their capacity hinders the ability of SOCBs to adjust and implement their strategies; given their reputation and accelerated expansion these SOCBs retain older clients with little banking knowledge, which makes it more difficult for SOCBs to close down unnecessary branches and to cut costs on low-skilled bank workers. In addition, SOCB employees can also take advantage of the reputation bestowed by the government to achieve their own goals. In contrast, JSCBs have to earn their reputation by themselves, which enables JSCBs to adjust their strategies according to the market change and to reduce the costs in physical branches.

In section four, we identified a special category of bank leaders in China's commercial banks: politician bank leaders. Because of their political ambition and their government background, the politician banks leaders in SOCBs tend to exchange the efficiency of the banks for economic growth, social stability and harmony. Some of the JSCBs, because they are partially owned by the government or by state-controlled enterprises, are also under the influence of politician bank leaders. Furthermore, the JSCBs that are wholly owned by the private sector, the regulatory institutions, can issue policies requiring banks to achieve the political goals of the government.

In the last section, we analysed how the restriction, due to government intervention, on senior managers' salary in SOCBs influences the management and efficiency of the banks. This salary restriction leads SOCB managers focusing on financial returns to withdraw from the competition within the SOCBs and, finally, leaves the SOCBs filled with employees striving to reach their personal political goals. As JSCBs are not required by the government to restrict the salary of senior managers, JSCBs can adjust the salary of their senior managers according to market change. This market-decided salary allows JSCBs to attract managers focusing on financial return from SOCBs and to motivate their employees and managers through salary.

Policy Implications

The partial privatisation of China's SOCBs started more than 15 years ago but has not demonstrated substantial progress since the SOCBs went public. At the same time, the state-owned capital did not express any intention to exit JSCBs. However, the financial market of the private sector is booming. The increasing number of newly established private banks and online financial service platforms shows the enthusiasm of the private sector in entering the banking industry. The discussion demonstrated that, as Chinese culture is collectivist and highly tolerant of power distance, and as the Chinese government is regarded as the patriarch in China, it becomes quite possible for the government to easily intervene in the management of banks through regulatory institutions, even though the government does not have any shares in a bank. However, such interventions are usually not beneficial to bank management and efficiency. For the emerging private banks, the government should leave enough space for future development. In addition, as the government can easily intervene in the management of commercial banks through regulatory institutions, the need for bank leaders who are also politicians is questionable. Their existence complexifies commercial banks' internal incentive institution setting and impairs the monitoring function of commercial banks. Last but not least, if the government plans to further the privatisation in the banking industry, it should cautiously take advantage of its power to intervene in bank management, especially in such areas as salary and dismissal that can be decided by the market. The lack of capable and active employees and senior managers, the low financial return and the high political and legal risks will make it much more difficult for SOCBs to carry out desirable reform plans for privatisation.

Further Applications

In this thesis, we gave priority to bank efficiency in discussing how the government influences the partially privatised banks. Because commercial banks constitute the most significant part of China's financial system, the conclusions reached here demonstrate that how government ownership participation in banks influences the efficiency and stability of the financial system needs further discussion.

Limitations

The first limitation of the thesis is that the collected data are not complete. Primarily, when analysing the efficiency of JSCBs, we did not include the JSCBs that are much smaller in scale and are not listed in mainland China, due to the difficulties in collecting open and reliable information about them. In addition, when analysing the interest on loans for state-owned enterprises, we could not determine the exact interest rate for such infrastructure construction programmes. Next, when analysing the salary of bank leaders, we did not consider the financial compensation to bank leaders of SOCBs that was potentially not declared. What is more, despite being audited by accounting firms, the annual reports and the social responsibility reports examined here were published by the banks, and other information was gathered by the banks themselves. There exists the possibility that banks can legally conceal some information and thus our data may not be complete or fully accurate. Last but not least, the thesis focused on information available at the end of 2018. New information was published during the writing process, and it is thus unavoidable that some newly released information with regard to SOCBs and JSCBs was omitted.

The second limitation of the thesis is the understanding of Chinese culture. The discussion of Chinese culture was based on three of the six dimensions of Hofstede's model and the work of Martin Jacques, which may reflect understanding at only a superficial level. The understanding focused on the relationship between the government and the banks, and the management implications influenced by the cultural factors. The other three dimensions of the Hofstede model, the structure of China's government and further understanding of Chinese culture may also influence the management of banks and bank privatisation. In addition, as both of these works were published around 10 years ago, Chinese culture and society may have changed during the intervening years.

Last but not least, some characteristics of banks and China's banking industry that could also influence their management and efficiency are not discussed in detail. For instance, how the money creation function of banks, accompanied by government holdings, may influence bank efficiency and bank management is not discussed. In addition, whether the recent interest rate liberalisation will influence bank efficiency and the role of the government during this process are also not discussed.

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Zusammenfassung

Diese Masterarbeit analysiert, wie die chinesische Regierung durch staatliche Holdings das Management und die Effizienz der wesentlichsten chinesischen Banken beeinflusst. Durch die Analyse der Beteiligungsverhältnisse zwischen den Banken und die Regierung wird es gezeigt, dass beide die staatseigenen Banken (SOCBs) und die Aktienbanken (JSCBs) teilweise vom öffentlichen Sektor besitzt werden. Basierend auf Bankgeschäftsberichten und einigen kulturellen Merkmalen Chinas kann ein Zusammenhang zwischen drei Faktoren festgestellt werden. Die SOCBs teilen den Ruf des Staates, was ihnen dabei hilft, Einlagen zu gewinnen und Bankläufe zu vermindern, jedoch ihre Kostensenkung und Strategieanpassung behindert. Im Gegensatz dazu teilen die JSCBs nicht das Ansehen des Staates, was sie dazu zwingt, ihre Strategien an die Marktveränderungen anzupassen. Dies wiederum ermöglicht ihnen jedoch, Technologien zur Kostensenkung einzusetzen. Die politisch orientierte Bankleiter können die Effizienz der Banken opfern, um Ihre politischen Ambitionen zu verwirklichen, und ihr Präsenz nicht nur auf staatlichen Geschäftsbanken beschränkt. Das von dem Staat eingeschränkte Entgelt behindert die Motivation der SOCB-Manager und -angestellten, aber es ermöglicht JSCBs jedoch, die Talente von den SOCBs anzuziehen.

Schlagwörter: Bank, Teilprivatisierung, Bankeffizienz, Bankleitung, staatseigene Bank, China