

Corporate governance in China's banking system

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ABSTRACT This paper explores the internal mechanisms within China's banking system including ownership structure, the Board of Directors, executive compensation and financial disclosure as well as the sub-topics of board diversity, cross listings and employee stock options. In addition, external mechanisms such as an effective takeover market, legal infrastructure and market competition will be analyzed. Online databases including EBSCO, Google Scholar and SSRN were used as sources for academic literature about the topic for this paper..

Keywords: Banking, corporate governance, decentralization, China

1. INTRODUCTION

In the People's Republic of China (PRC), in an effort to decentralize the People's Bank of China (PBC), the nation's four largest banks were created as "policy banks" in the early 1980's and became widely known as the "Big Four": Agricultural Bank of China (ABC), Bank of China (BOC), China Construction Bank (CCB) and the Industrial and Commercial Bank of China (ICBC) (Brean, 2007). "Following the 1995 release of the Commercial Bank Law and Central Bank Law, ICBC, ABC, BOC and CCB began to function as commercial banks, subject to new rules and regulations holding them responsible for their profits and losses" (Chen & Thomas, 1999, p. 18).

In the 1990's, the government imposed a series of three major bank reforms on the Big Four banks including recapitalization with government bonds, abolishment of the credit quota policy and transfer of non-performing loans to state-owned asset management companies (Brean, 2007). The banks operate as commercial banks, whose principal shareholder is the Chinese government, and are cross-listed on multiple exchanges in China and other countries such as Germany, Hong Kong and the USA.

Over the past ten years, the banking sector in China has seen unprecedented growth fueled by real estate development and the surge of capitalism throughout the nation. With the state being both the principal shareholder and regulator of China's banks, corporate governance reform is a priority. Today's economic and financial climate reflects "narrowed interest margins and rising bad loans amid economic uncertainty" coupled with a "challenging economic environment" (Wang, 2012). Also, compensation for financial executives is being scrutinized.

Based on the concept of corporate governance as a set of mechanisms (Denis & McConnell, 2003), this empirical research paper explores the internal mechanisms within China's banking system including ownership structure, the Board of Directors, executive compensation and financial disclosure as well as the sub-topics of board diversity, cross listings and employee stock options. In addition, external mechanisms such as an effective takeover market, legal infrastructure and market competition will be analyzed.

2. INTERNAL GOVERNANCE MECHANISMS

2.1. Ownership Structure

Liu (2005) argued that the corporate governance practices by listed firms in China are based on “a control-based model, in which the controlling shareholders (in most cases, the state) tightly control the listed firms through concentrated ownership” (p. 10). Tian & Lau (2001) stated that “the ability of the directors who represent banks and other financial institutions to monitor the managers is questionable” and that “reform progress in China’s banking sector has been slower than in its industrial sector” (p. 249). Furthermore, “the state as owner faces many conflicts of interest as it is also the regulator and enforcer of laws, regulates and often controls the banking system, and more generally is concerned about other factors, such as employment” (Claessens & Fan, 2003, p. 9). When the largest shareholders are the state, the firms tend to be tightly controlled through concentrated ownership, bureaucrat-filled boards and exhibit low transparency in operations as the companies are conduits for political agendas (Liu, 2005). “The conversion from state to private ownership, termed privatization, provides an interesting setting in which to examine the effects of ownership on firm performance” (Denis & McConnell, 2003, p. 3). Finally, there is an overall positive relation between ownership concentration and profitability in Chinese firms; this relation is stronger when blockholders are financial institutions than when the state is the primary blockholder (Xu & Wang, 1997). The following data represents the ownership structure and cross-listings of China’s four largest state-owned commercial banks.

According to ABC’s 2012 annual report, the bank has two primary, state-owned shareholders: the Ministry of Finance (MOF) and Central Huijin Investment, Ltd. (Huijin). The MOF was established in 1949 as a ministry under the State Council and is focused on state finance and taxation while Huijin is a wholly-owned subsidiary of China Investment Corporation. Huijin makes equity investments in key state-owned financial corporations as authorized by the State Council, and exercises the contributor’s rights and obligations in key state-owned financial corporations up to its contribution on behalf of the state to achieve preservation and appreciation of state-owned financial assets. Between these two state shareholders, MOF and Huijin, state-owned shares comprise a total of 82.7% (ABC, 2013, p. 103).

BOC’s 2012 annual report shows that Huijin owns 67.6% of the bank and is the primary shareholder. Other state-owned shareholders include China Life Insurance Co. Ltd., PICC Property & Casualty Co. Ltd., Shenhua Group Corp. Ltd. and Aluminum Corporation of China. Overall, 67.95% of BOC is owned by the state or “state-owned legal persons” while non-state/foreign owners include HKSCC Nominees Ltd. (29.12%), the Bank of Tokyo-Mitsubishi UFJ Ltd. (0.19%) and Asian Development Bank (0.11%). (BOC, 2013, p. 82).

CCB’s 2012 annual report shows that Huijin is the controlling shareholder of the bank with 57.21% of the shares. Other state shareholders include Baosteel Group (0.8%), State Grid (1.16%) and Yangtze Power (0.41%) for a total of 59.41% of the shares being state owned foreign owners of CCB include Bank of America (0.8%) and Reca Investment Ltd. (0.34%). (CCB, 2013, p. 53).

Huijin increased its share ownership of ICBC to 35.46% of the bank’s total issued share capital while the MOF owns 35.3%. HKSCC Nominees Limited, a subsidiary of Hong Kong Securities

Clearing Corp. (the registered shareholder of listed companies) owns 24.6% of ICBC's "H" shares. Various Chinese state-owned insurance companies round out the list of the bank's top ten shareholders (ICBC, 2013).

At the Big Four banks, employees are not given the option to receive bank shares as compensation nor do they have stock option purchase plans. Ning and Zhou (2005) found that "negligible fractional ownership does not provide meaningful employee incentives" in China. In 1992, China introduced employee stock ownership plans (ESOPs) as an employee incentive scheme. The policy experiment with state-owned enterprises was terminated 2 years later (Meng, Ning, Zhou & Zhu, 2011).

2.2. Board of Directors

By way of the Board of Directors, shareholders can exert influence on the behavior of managers to ensure that the company is run in their interests (Liu, 2005). Around 2006, China's state-owned banks adopted a dual-board system where "the board of directors oversees and guides the operation of management; the board of supervisors guides and gives advice to the board of directors" (Wai-Chung & Ng, 2009, p. 23). "In the Chinese unique corporate governance system, the supervisory board is not responsible for daily operations of the company, but serves as one of the two monitoring organs, together with the independent directors ..." (Ding, Wu, Li & Jia, 2009, p. 5).

One of the most serious governance concerns of Chinese investors is company boards without independent directors (Ow-Yong, 2007). "According to guidelines issued by the China Security Regulation Committee (CSRC) at least one-third of the board members should be independent directors" (Wai-Chung & Ng, 2009, p. 25). Historically, almost all of the independent directors that sat on bank boards in China were male politicians and state controlling agents and there are "almost no representatives of minority shareholders" (Liu, 2005, p. 9). In terms of diversity, three of the Big Four bank boards have women directors, a positive sign of change in China's male dominated business culture. The following data reviews the structure of the four state-owned commercial banks in China.

ABC's board consists of 15 directors: 4 executive directors, 6 non-executive directors and 5 independent directors (ABChina.com, 2013). The all-male board consists of directors from mainland China, with the exception of two from Hong Kong. Notably, one of the Hong Kong directors is Mr. Anthony Wu Ting Yuk, who is involved in "the longest outstanding disciplinary case of the Hong Kong Institute of Certified Public Accountants," of which he is the Chairman (Winn, 2012).

BOC's board consists of 14 directors: the Board Chairman, 2 executive directors, 5 non-executive directors and 6 independent directors. In terms of diversity, there are 4 women and 12 men, all Chinese nationals, with the exception of one Dutch national, Mr. Nout Wellink (BOC.CN, 2013). CCB's board consists of 12 members: 2 executive directors, 5 non-executive directors and 5 independent directors. In terms of diversity, the board consists of 8 men and 4 women, all of which all are Chinese nationals, with the exception of one director from the United States, Elaine La Roche, and one New Zealand national, the former Prime Minister, Jenny Shipley (CCB, 2013).

ICBC's board is composed of 15 directors: 4 executive directors, 7 non-executive directors and 4 independent directors. There are 2 women directors on the board and all of the directors are Chinese nationals, with the exception of one British national, Sir Malcolm Christopher McCarthy (ICBC, 2013). According to the articles of association of ICBC, the term of each director is 3 years and directors are eligible for re-election upon completion of their term (ICBC-LTD.COM, 2013). The occupation of most bank directors in China is a hodge-podge of academics and high-level bureaucrats who seem to play a game of musical chairs by jumping from a provincial government post to a bank board and on to a central government finance role. In the long term, if China's banks are to become better managed and monitored, the type of bank director appointed needs to be more of a financier than a *politico*.

Table 1: Board of Directors: China's Big Four Banks (end of 2013)

Bank	Directors	Men	Women
ABC	15	15	0
BOC	16	12	4
CCB	12	8	4
ICBC	15	13	2
Average	15	12	3

2.3. Executive compensation

In China's banking sector, executive compensation is an evolving area of concern as corporate governance becomes more mature. "While executive stock options are widely used in the West, it is unusual to give such incentives in China where compensation consists mainly of the base wage ... which may embed performance-related pay from the past or present period" (Fung, Firth and Rui, 2001, pp. 4 - 5). "The heads of China's biggest state-owned banks are appointed by Beijing, and enjoy vice minister status" (Gu, 2012) and "are assigned by the ruling Communist Party's central organization unit (Soo, 2012). Furthermore, The China Banking Regulatory Commission (CBRC, 2010) defines compensation as:

the remuneration and other related benefits provided by a commercial bank for its employees to reward their services and contribution, which include base salary, performance-linked compensation (merit pay), medium- and long-term incentives, welfare benefits, and other cash or equity payments (Article 2.)

In 2008, China's Finance Ministry imposed 10% salary cuts as part of financial executive pay reform with performance appraisals at its core as top executives at listed financial institutions earned an average salary of 604,600 RMB, the highest among all industries in China (AFP, 2009). The following data represents the total compensation for the top executives at China's state-owned commercial banks.

In 2012, Jiang Chaoliang, Chairman of ABC, had a total compensation of 1,129,000 RMB, President, Zhang Yun, received 1,107,000 RMB and Guo Haoda, Vice President, received 925,000 RMB in total annual remuneration (ABC, 2013, p. 125). All of them serve as Executive Directors on the Board of ABC.

For the fiscal year 2012, Li Lihui, BOC's President and Vice Chairman, earned a total compensation of 1,013,100 RMB, Li Zaohang, Executive Vice President, received 972,600 RMB and Wang Yangli, Executive Vice President, received 944,600 RMB. Chim Wai Kin, Chief Credit Officer, received a total remuneration of 5,960,600 RMB and Ms. Liu Yanfen, Chief Auditor, received 1,208,400 RMB (BOC, 2013). In 2012, BOC incurred 23.87 million RMB in remuneration to its directors, supervisors and senior management (BOC, 2013, p. 80).

Compensation for CCB's chairman has varied, dropping to 1.57 million RMB in 2008 before rising to as much as 1.83 million RMB in 2010 (Soo, 2012). CCB's Executive Chairman, Wang Hongzhang, had a total compensation of 1,076,000 RMB for 2012 while Zhang Jianguo, Vice Chairman and President, received 1,056,000 RMB (Bloomberg Businessweek, 2013). Zhang Furong, Chairman of the Board of Supervisors, received 1,032,000 RMB in total remuneration in 2012 (CCB, 2013, p. 73).

In 2012, ICBC's Executive Chairman, Jiang Jianqing, received 1,136,000 RMB in compensation, Yang Kaisheng, President and Vice Chairman, earned a total of RMB 1,104,600 RMB and Zhao Lin, Chairman of the Board of Supervisors, earned 1,022,000 RMB (ICBC, 2013).

In its 2010 Annual Report, the CBRC resolved "to strengthen the role of compensation practices in refining the corporate governance, internal controls and risk management of commercial banks" (CBRC, 2010). In March of 2012, the CBRC created a new regulation that requires bankers to return the part of their salary related to bad loans (Feng & Wen, 2012). "Agency theory argues that there should be a positive relationship between CEO pay and financial performance" (Fung, Firth & Rui, 2001, p. 1). Kato and Long (2006) posited "the relationship between firm performance and executive compensation is weaker for firms with a higher percentage of government ownership, suggesting that the interests of top executives in firms that are less state-controlled are more in line with those of the shareholders" (p. 947).

China's Big Four bank chiefs are grossly undercompensated compared to their Western counterparts such as Jamie Dimon of JPMorgan Chase, who made \$23 million in 2011 (Soo, 2012). Despite the low salaries for top bankers in China, there are many invisible perks such as automobiles, gifts and houses via the local tradition known as *guanxi*.

2.4. Financial disclosure

Transparency and the disclosure of financial information has been a significant issue with the Chinese banking system for many years as the system has evolved from a planned economy to a market economy. The following elements will be reviewed in regards to financial disclosure and transparency: accounting standards, IPO's, organizational memberships and tunneling of assets.

It used to be in China that most listed companies were audited by local accounting firms, so little or no reliable information existed to determine which accounting firms were credible (Liu, 2005,

p. 7). Today, the Big Four banks are externally audited by global accounting firms such as Ernst & Young, PricewaterhouseCoopers (PWC) and Deloitte Touche Tohmatsu in accordance with accounting standards such as PRC GAAP and IFRS. "Banks which have adopted international accounting standards experience a higher growth rate of deposits than institutions that utilize local accounting standards in compiling their financial reports" (Wu & Bowe, 2012, p. 18) In the case of Chinese state-owned banks, there is a correlation between ownership and financial disclosure. Furthermore, Wu and Bowe (2010) argued that "state ownership undermines bank performance; a fact attributed to poor corporate governance and reduced incentives to improve operational efficiency" (p. 160).

In order to take the Big Four banks public on stock markets in Shanghai and Hong Kong, the banks had to eradicate their massive portfolios of non-performing loans (NPLs), estimated to be between 1 and 3 trillion RMB in 1998 (Chen & Thomas, 1999). In 1999, four asset management companies were formed to repackage the non-performing loans into viable assets and sell them off to the investors (Cheng & Nasir, 2011). As the banks lacked the necessary control mechanisms that are a critical part of corporate governance, the PBC provided billions of RMB as a form of capital infusion, as the banks were considered to be financially insolvent (Thompson, 2005). "When banks disclose more information in relation to items such as the composition of their loan portfolios, off-balance guarantees, and the maturity structure of their investments, they expose themselves more to the discipline of market forces" (Wu & Bowe, 2009, p. 180). By 2010, all of the Big Four banks had gone public showing "a gradual displacement of state ownership by private equity" (Wu & Bowe, 2012, p. 6).

Part of China's emergence into capitalism involves a sequence of events with various diplomatic and financial organizations. In 1996, the Bank for International Settlement admitted China which resulted in the Big Four banks cleaning up their balance sheets and improving their financial reporting (Guyot, 1996). In 2001, additional pressure for financial disclosure was placed on banks in China with the country's new membership in the World Trade Organization. In 2003, the China Banking Regulatory Committee was established to regulate and monitor banks while transparency still remained elusive in the banking industry (Zhang, Chiu & Wei, 2009, p. 21). Eventually, China hopes to become a member of the OECD convention.

With its roots in Communist privatization and corporatization, tunneling is defined as "the transfer of resources out of firms for the benefit of controlling shareholders" and is a serious agency problem in emerging financial markets such as China (Liu, 2005). Chen, Jian and Xu (2009) argued that with publicly listed companies, dividends are not always used for the distribution of free cash flows in China, but may be used by the controlling shareholders to engage in tunneling. From 1996 to 2006, hundreds of publicly traded firms with concentrated, state ownership, diverted tens of billions in RMB into the coffers of state run units by way of inter-corporate loans that were never repaid (Jiang, Lee & Yue, 2010).

3. EXTERNAL MECHANISMS

3.1. Effective takeover market

Empirical studies suggest that takeovers significantly increase the market value of target firms (Liu, 2005, p. 8). Furthermore, takeovers as a corporate control mechanism are substantially diluted in a market that lacks transparency, financial disclosure, compliance and regulation (Wei, 2007). "Changes in the control of firms virtually always occur at a premium, thereby creating value for the target firm's shareholders" (Denis & McConnell, 2003, p. 40). An active corporate control market does not exist in China, particularly among the Big Four banks. However, there are some different ways to look at this external mechanism.

By analyzing the second to tenth largest shareholders of each of the Big Four banks, Liu (2005) cited three reasons for this scenario to have a positive impact on the corporate governance level of a firm (p. 8). First, "large shareholders other than the largest one are obstacles to tunneling activities by the largest shareholder because these shareholders have incentives to monitor and restrain the largest shareholder" (Liu, 2005, p. 8). Second, "the efficiency of the market for corporate control is enhanced because these large shareholders can either initiate a fight for corporate control or assist an outsider's fight for control when the existing management underperforms" (Liu, 2005, p. 8). Third, "these large shareholders have an incentive to monitor the management directly" (Liu, 2005, p. 8). As long as the central government remains the concentrated owner of the Big Four banks, there will be minimal change in behavior. It will take actions by the other large shareholders to act as agents for change. Conversely, Denis and McConnell (2003) argued:

In addition to being a potential solution to the manager/shareholder agency problem, it can be a manifestation of this problem. Managers interested in maximizing the size of their business empires can waste corporate resources by overpaying for acquisitions rather than returning cash to the shareholder (p. 4).

In China, "mergers and acquisitions with other firms are preferred to bankruptcy, and it has been documented that M&As have been indeed used extensively to resolve firms' distress" (Allen, Qian, Zhang & Zhao, 2011, p. 20). As the Big Four banks have plenty of resources to make acquisitions, the following are some examples of this activity in recent years.

"Buying a minority stake in a foreign bank or insurer is the most common route for Chinese financial institutions looking to test global waters ..." (Ngai & Wang, 2008). ICBC has been particularly active in acquiring minority stakes in foreign banks. In 2007, ICBC purchased a 20% stake in Standard Bank of South Africa for \$5.6 billion and recently received approval for an 80% stake in Standard Bank's assets in Argentina valued at \$600 million (Xinhua.net, 2012). In May of 2012, the U.S. Federal Reserve approved ICBC's acquisition of an 80% stake in BEA's US subsidiary, opening the door for Chinese banks to enter the U.S. market via acquisitions or establishing branches (Myles, 2012). Bank of America sold its Hong Kong retail operations to China Construction Bank (CCB) in 2006 for \$1.25 billion (Ngai & Wang, 2008) and in 2009 CCB acquired AIG Finance in Hong Kong (CCB Asia, 2012).

The tables have turned as stock prices for American and European banks plummet while profit margins for China's banks rise, as does their plans for globalization and expansion.

3.2. Legal infrastructure

La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998) argued that "the extent to which a country's laws protect investor rights and the extent to which those laws are enforced are the most basic determinants of the ways in which corporate finance and corporate governance evolve in that country." Based on this premise, this paper utilizes the legal framework of the stock exchanges where the Big Four banks are listed and traded. One shared element between all four banks is that they are all listed on the Shanghai, Hong Kong and American OTC Markets Group. In addition, BOC and CCB are traded on stock exchanges in Frankfurt, Germany.

The Shanghai and Shenzhen stock markets were created in 1990 and, like China's real estate market, have seen unprecedented growth in the past two decades (Allen et al, 2011). While 'administrative governance' has played an active role in the development of the Chinese stock market, "government relations are also sources of many problems in the Chinese stock market" (Liu, 2005, p. 20). The following data shows the cross-listings of the Big Four banks in China.

ABC is publicly traded on the following: the Hong Kong Stock Exchange (1288), the Shanghai Stock Exchange (601288), the Frankfurt Stock Exchange (EK7) and the OTC Markets Group (ACGBF & ACGBY) (Bloomberg Businessweek, 2013). ABC's IPO in 2010 was the last of the Big Four banks, ending the era in China's banking sector where the government spent tens of billions of RMB to clean up balance sheets every year (Liu, 2010). The total proceeds from its IPO from HKSE (July 16, 2010) and SHSE (July 15, 2010) reached \$22.1 billion (Allen et al, 2011).

BOC is publicly traded on the following: Hong Kong Stock Exchange (3988), Shanghai Stock Exchange (601988), Frankfurt Stock Exchange (W8V) and the OTC Markets Group (BACHF & BACHY) (Bloomberg Businessweek, 2013). Chinese companies listing on the Frankfurt Stock Exchange are becoming more common because of the Wholly Foreign-Owned Entity (WFOE) legal business structure, as established under Chinese law. It creates a Chinese company, owned and managed by foreign investors without any involvement from a Chinese partner with the caveat that mainland Chinese nationals are not allowed to own shares in a WFOE (FSE, 2012).

CCB is publicly traded on the following: Hong Kong Stock Exchange (939), Shanghai Stock Exchange (601939), Xetra (C6T) and the OTC Markets Group (CICHF & CICHY) (Bloomberg Businessweek, 2013). Xetra is an electronic trading system owned by the Deutsche Börse in Frankfurt, Germany and is used by exchanges in Europe and Shanghai (Xetra, 2012). ICBC is publicly traded on the following: Hong Kong Stock Exchange (1398), Shanghai Stock Exchange (601398) and the OTC Markets Group (IDCBY) (Bloomberg Businessweek, 2013). ICBC was simultaneously listed on both the Hong Kong Stock Exchange and Shanghai Stock Exchange in October of 2006 and, at the time, was heralded as the world's largest IPO with a value of \$21.9 billion. (Allen et al, 2011).

Table 2: Stock exchange listings for the Big Four banks of China

Bank	Shanghai	Hong Kong	OTC Markets	Frankfurt	Xetra
ABC	601288	1288	ACGBF ACGBY		
BOC	601988	3988	BACHF BACHY	W8V	
CCB	601939	939	CICHF, CICHY		C6T
ICBC	601398	1398	IDCBY		

4. MARKET COMPETITION

Ye, Xu and Fang (2012) posited that policy makers should promote further competition in the Chinese banking sector. Conversely, competition may encourage unethical behaviors and companies in disadvantageous positions may demonstrate stronger propensities to hide profits while competitive pressure may discipline the management (Liu, 2005, p. 19). As an example, Cai and Liu (2009) discovered that market competition affects firms' incentives to avoid corporate income tax, based on their study of Chinese industrial firms. Finally, the Chinese banking sector is rife with competition, from both domestic and foreign banks, and there are many options to the services offered by the Big Four banks.

After the Commercial Bank Law and Central Bank Law became effective in the 1990's, the establishment of "share-ownership" or "joint-stock" commercial banks began to appear in China (Chen & Thomas, 1999, p. 18). Outside of the Big Four banks, these include banks such as the Bank of Communications, of which HSBC is a 19.03% shareholder (Bankcomm, 2012), and China Merchants Bank which "has no controlling shareholder or actual controlling party" and whose largest shareholder is China Merchants Steam Navigation Company Ltd., which holds a 12.40% stake (CMBChina.com, 2012). In the case of the Big Four banks as joint-stock companies, "state shares are prohibited to be traded on the stock market" and "state-owned legal person shares can only be transferred among legal persons" (Wei, 2007, p. 340). Only individual shares in a Chinese joint-stock company can be freely traded. Cui (2012) observed that "non state-owned banks have more potential competitiveness than others" and that "a sound internal control mechanism should be established to optimize corporate governance structure" (p. 154).

Furthermore, urban commercial banks spawned from China's urban credit cooperatives while foreign banks, which had dominated in China up until 1949, are slowly gaining market share as they introduce more competition and improve efficiency. For some foreign banks, smaller, urban banks make for less risky investments in the Chinese banking sector. ANZ (Australia and New Zealand) Banking Group invested in the Tianjin City Commercial Bank and the Shanghai Rural Commercial Bank while the Commonwealth Bank of Australia invested in the Hangzhou City Commercial Bank and the Jinan City Commercial Bank (Tan, 2009). According to Tan (2009), "corporate governance in the Chinese city commercial banks was minimal before the Australian banks invested ... since then, there have been substantial improvements" (p. 209).

In addition to the Australians, banking groups from other parts of Asia, Europe and North America have staked a claim in China's banking sector, especially in Shanghai. Moreover, many foreign banks are able to offer "banking, insurance, and investment services to customers from

a single source” as well as provide access to international branches around the globe (Bin, Locke & Willette, 2003, p. 248). Allen et al (2011) asserted that “the entrance of more non-state (domestic and foreign) banks and intermediaries, is good for improving the efficiency of both the Big Four banks and the entire sector” (p. 18). Foreign banks in China as a sector posted record profits of 16.73 billion RMB, while total assets grew to 2.15 trillion RMB (Metcalf, 2012).

As China continues to transform from a planned economy to a market economy, their market focus is shifting from manufacturing goods for export to becoming an innovation and information driven market and a service-based economy. This paradigm shift provides a wide range of financial opportunities for foreign banks that have strategic insights and experience in knowledge-based services. Finally, there is a large void of financial talent in China, providing opportunities for foreign bankers and financiers looking to arbitrage their skills and expertise. Salaries are improving in China and are becoming aligned with Western banker’s compensation.

5. CONCLUSION

Good corporate governance facilitates the transparent operation of the banking sector, while an orderly performing banking sector can greatly promote good corporate practice in listed companies in China. The global financial crisis of 2008 – 2009 severely changed the banking and financial services industry, causing the dominance of capital markets to shift geographically from the West to the East. While China’s Big Four state-owned banks are not only too big to fail, they are too important to fail, as these banks have created an alchemy of politics and finance by underwriting huge infrastructure projects that control millions of jobs in China and have a substantial effect on foreign direct investment. Chinese banks are experiencing mercurial growth and are being forced to improve their corporate governance standards in order to be more aligned with their Western counterparts.

While the U.S. is allowing Chinese banks to open branches in America and acquire ownership in existing banks there, London is clamping down on the presence of the Big Four banks in the United Kingdom by enforcing firm standards on transparency and other critical governance mechanisms. Essentially, the governments of most nations want a banking culture that promotes transparency, business efficiency, fair competition and managerial accountability.

In order to develop a sustainable economy, corporate governance must be an integral part of a country’s banking system. At the 13th China Development Forum, CBRC Chairman, Shang Fulin offered to “help banking institutions to improve corporate governance, strengthen internal controls and improve forward looking and effectiveness of risk management” (Metcalf, 2012, p.8). To achieve these goals, China’s Big Four banks will have to glean itself of concentrated ownership from the central government and start making decisions based on financial acumen as opposed to addressing political agendas and directives. Moreover, the central government should wholly separate the role of regulator of the banks while it is the concentrated owner.

In order to have ethical and unbiased regulation, there must be a separate regulatory body whose interests do not coincide with the primary shareholder. Finally, the directors should be seasoned bankers capable of addressing the long term goals of the banks. The practical applications of opening up the ownership of the Big Four banks to both non-state and minority

shareholders will allow the banks to see an increase in productivity and profitability that is not hindered by deception and graft. Also, more qualified bankers, as opposed to relationship-driven bureaucrats, will be drawn to joining the Big Four banks, allowing China to compete more vigorously in the arena of world banking and capital markets.

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