Institutions, FDI and Capabilities in the Development of Chinese Banking: an Analysis of Banks in Hunan Province

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Declaration of Authorship

I, Weijia Zhu, hereby declare that this thesis and the work presented in it is entirely my own. Where I have consulted the work of others, this is always clearly stated.

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Abstract

This thesis analyses the development of Chinese banking since the period of economic reform and particularly since 2003. Existing studies are limited in number, and lack depth of analysis and an understanding of Chinese banks at an operational level. This thesis is founded on firm-level research, and it assesses the extent to which management practices have changed. It focuses specifically on human resources, product development, client relationships, and information technology, which are the resources and capabilities regarded as strategically important to banking firms. In order to explain why and how changes to China's banking have been implemented, the thesis evaluates the impact of foreign direct investment (FDI) by multinationals with knowledge of international best practice, and it demonstrates the importance of the regulatory body appointed as a consequence of policy and institutional reform to accelerate the industry's performance. The thesis examines FDI and institutionalist theories and their relevance to the development of China's banking industry. It offers five case-studies of banks in Hunan province, selected to represent different types of banks and to facilitate comparisons: three former directly-owned banks, the China Construction Bank, the Bank of China, and the Industrial and Commercial Bank of China; one national commercial bank, the China CITIC Bank; and one provincial commercial bank, the Huarong Xiangjiang Bank. Through case comparisons, the thesis considers the relative effect of foreign multinationals and institutional pressures, and their relationship to technological and market factors. In order to assess their influence, it utilizes ideas on strategic management and core capabilities. The thesis reveals how Chinese banks have developed their management practices and performance, adds substantially to our empirical knowledge of the Chinese banking industry, and offers insights for management theory and practice.

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Chapter 1

Introduction: Banking Reform in China

This thesis focuses on the strategic and organizational changes introduced to China's banking industry. The topic is important because the country, for its next stage of economic development, needs to raise the competitiveness of China's service and finance sector, in order to support small and medium sized enterprises, stimulate domestic demand, and transform the inland provinces. To obviate the risks of China's development model – focused on government intervention and support, infrastructure investment and high indebtedness in state-owned business - the creation of a more service orientated, performance-driven and internationally competitive banking industry has emerged as a policy objective. To interpret the significance of the evolution of Chinese banks, this thesis has called upon ideas about the cross-border transfer of management know-how and practices through alliances with foreign multinational firms. In addition, it utilizes and assesses the literature on the influence of national government and institutions in determining management practice at the operational level of firms. After surveying the nature of banking in China, since the inception of reform, the thesis concentrates on more recent changes in firm practices and capabilities. It employs concepts from business strategy and adopts them to an understanding of bank firms in the context of a developing and transitional economy. This case-driven research supplies new evidence on a vital industry, and offers lessons for academic research, policy makers and managers.

From 1978, the Chinese government implemented economic reform, and inward FDI has been considered one of the key factors to economic growth by bringing capital, advanced technology, and managerial skills. To date, most of this inward investment has flowed to manufacturing. The Chinese banking sector has largely lagged behind the successes of industry, as the government has tended to protect it from international competition and has not opened the industry to foreign investors. After China joined the World Trade Organization (WTO) in 2002, it was committed to liberalizing the banking sector, including removing restrictions on foreign banks. Therefore, in 2003, it established the China Banking Regulatory Commission (CBRC) to oversee industry regulation and the process of bank reform in Mainland China, including initiatives in inward foreign direct investment (FDI). The CBRC was responsible, too, for improving the industry's performance in management, employee skills, marketing and technological capabilities to meet the needs of individual customers and businesses. In evaluating the extent and the success of these developments, this thesis considers the degree to which the causes of the changes have been international partnerships, institutional pressure, or managerial initiative. This chapter begins firstly with the propositions of the thesis, which address these issues. It notes secondly the contribution of the research to our understanding of Chinese banks and the processes of economic transformation. It presents thirdly the structure of this thesis.

1.1 Research Propositions

To what extent and in what ways have China's banks been able to develop their strategic resources and capabilities in personnel, products and client networks in readiness for increasing domestic and international competition?

There has been no detailed case study of China's banks investigating their strategic resources and capabilities, nor any that has studied empirically what has changed in their organization over the last decade, particularly at the operational branch level. Therefore, there is a need to analyse the development of Chinese banks in order to discover the resources and capabilities required by banking firms within the context of China's transitional and institutional economy, if they are to pursue sustainable competitive advantages.

How effectively does FDI theory adequately explain how capabilities and global 'best practices' have been implemented and developed at the operational branch level of Chinese banks?

As service industries, such as banks, require different mixes of resources and capabilities to manufacturing concerns, and as banks may need to develop many key capabilities in combination with customers and markets, the transfer of capabilities through FDI may not be so effective or may need to be applied differently. In examples of FDI in which a parent multinational owns or controls a subsidiary, or has a major stake in a joint venture, the foreign investor has in principle a mechanism for transferring its capabilities. As we shall see, in the example of Chinese banks, the levels of ownership and control open to a foreign investor were minimized, and yet the transfer or adaptation of global 'best practice' did occur. The cases in this thesis explore how new practices were embedded in Chinese banks, and to what extent they copied systems used overseas or introduced hybrid outcomes. They show the link between engagement with foreign multinationals through FDI and the enhancement of firm level strategic capabilities, which has had so far limited empirical investigation. On the other hand, the cases reveal why FDI and strategic

alliances with multinationals cannot offer a full explanation of the reform of Chinese banks.

To what extent is the CBRC, the formative regulatory institution, responsible for the development of capabilities in Chinese banks?

In a market-based view of transition economies, institutions are considered as blocks on the transformation process, because government and regulation inhibit the emergence of competitive market mechanisms. In the late development perspective, government and other institutions are an important factor of economic development during its initial stages. Do ideas on transitional economies about institutional barriers holding back the process of market reform reflect the reality of China's bank industry? Furthermore, how valid is the notion of strong isomorphic pressures in the theory of national institutions, implying that there would be little scope for management initiative and variations in firm capability? Chinese banking cases show that isomorphic pressures have not inhibited the evolution of firm-level or differentiated capabilities, nor hindered the transfer or emulation of international best practice. The China Banking Regulatory Commission (CBRC) has, nonetheless, emerged as the key component for reforming banks and enhancing their capabilities.

While we must consider the effects of foreign multinational investors, transferred international practices, and formative institutions, the unit of analysis for our research remains the individual bank and the focus is on the investigation of firm-level capability development. The thesis shows the development of bank resources and capabilities in China in the period since 2003, and concentrates on matters of human resources, remuneration,

training, qualifications, products and services, technology, and client networks. The comparative case studies enable an assessment of the extent to which Chinese banks have become competitively differentiated from each other, and the extent to which changes are driven by firm-level capabilities as opposed to external influences such as FDI and national institutions. What is interesting about the recent evolution of Chinese banks is the link between internationally transferred practices and strategic capabilities, and, in contrast to the example of many manufacturing initiatives, the strong link between institutional influences and firm-level capability. This thesis utilizes ideas from the Resource Based View (RBV) of business strategy to define the resources and capabilities needed by a bank firm to achieve a sustained competitive advantage. It notes furthermore the context of foreign multinational alliances, transition from a controlled economy, institutions, and levels of economic development and consumer expectations, as well as technological factors. The thesis employs as a consequence ideas from the Dynamic Capabilities Approach (DCA) of business strategy, in order to incorporate influences on resource and capability development that are external to the firm, and to appreciate more comprehensively the processes of capability development over time.

1.2 The Significance of the Research

This research is significant from three perspectives. Firstly, it identities gaps in existing studies on Chinese banks, and it is the first empirically based attempt to analyse Chinese banks and to assess their operational capability over time.

Secondly, this thesis draws on extensive new sources of information. It utilizes a range of secondary data sources written in both English and Chinese, including reports produced by government, companies' internal documents,

newspapers, trade magazines, journal articles, and books. Fundamentally, it addresses the research topic through primary information directly collected, for the first time, through semi-structured face-to face interviews. The interviewees were carefully selected in order to gather accurate and broad perspectives. They had a variety of ranks in different departments. It is difficult to obtain primary interviews from Chinese banks, due to government controls and expectations on safeguarding corporate information. Thirdly, business practitioners will find this research highly valuable. The thesis discusses the factors that lead to improved Chinese bank performance, and the implementation of effective strategies. The findings of the study will help with a grounded understanding of dynamic capability at an operational level. This research is useful for government's FDI policy makers. It can inform them about which deals are likely to produce the expected positive outcomes, and which should be encouraged through incentives and which through regulations.

1.3 Outline of Thesis

The thesis consists of ten chapters. Chapter 1 introduces the research topic, and the propositions guiding the research. Chapter 2 introduces the background to the Chinese economy and the reform of the Chinese banking sector. It explores the achievements and limitations of Chinese banking sector reform since 1978. It addresses the contribution of FDI to the Chinese economy, and suggests how FDI could contribute to Chinese bank capability. Chapter 3 reviews the literature on institutionalism and strategic management. It demonstrates the shortcomings of extant studies and explores how existing perspectives cannot explain how firms might develop their capabilities under the strong control of regulatory institutions. Chapter 4 outlines the methodology. It explains why the thesis adopted the multiple case study

approach based on qualitative interviews, and the advantages of triangulating with internal documents, newspapers and articles. It explains the choice of cases and interviewees. It describes the research process, and how the data have been collected and analysed.

Chapter 5 examines the China Construction Bank (CCB) case. CCB was established before 1978, as one of the big four state owned banks, and it was one of the pilots to initiate reform after the establishment of the CBRC. Chapter 6 considers the Bank of China case (BOC). As with CCB, it was one of the big state owned banks, and chosen by CBRC to begin the reform agenda. Chapter 7 deals with the Industrial and Commercial Bank of China case (ICBC), one of the large state owned banks, its reform starting after CCB and BOC. Chapter 8 examines the China CITIC Bank case (CITIC Bank), one of the biggest banks not to have been one of the four state-owned firms. Chapter 9 looks at the Huarong Xiangjiang Bank case (HXBC), which is a provincial level commercial bank. Chapter 10 analyses the findings from the five case studies comparatively, and draws conclusions by drawing on theoretical insights and empirical evidence.

Chapter 2

Economic Development, FDI, and the Banking Sector

2.1 The Achievement of the Chinese Economy

The Chinese economy grew quickly under economic reform, from 1978, achieving average annual growth in gross domestic product (GDP) of 10 per cent (National Bureau of Statistics of China, 2007). In 1979, the Chinese government permitted joint ventures between SOEs and foreign private companies, and established which industrial sectors would receive FDI, the aim being to learn advanced management and innovation. After 1986, China permitted the establishment of wholly owned subsidiaries in selected industries. For successive years, China became the number one location of inward FDI. In 2003, the year in which the reform of the banking sector was prioritized, foreign investment reached nearly $85bn (UNCTAD, 2004; Yao et al, 2004). Overall, FDI has been considered a major accelerating force behind Chinese economic growth. However, most of the inward investment flowed to manufacturing.

Despite the country's economic success, the financial sector has lagged. Analysis of Chinese economic reform since 1978 often pays inadequate attention to services and finance (Chen, 2009; Ferri, 2009). After China joined the WTO in 2002, the Chinese government promised the liberalization of the finance sector, including allowing firms to determine their lending rates, removing restrictions on foreign banks, and non-discriminatory taxes. The policy change implied more opportunities for foreign investors. By the end of 2006, there were over 300 foreign banks or representative offices or joint

ventures with Chinese banks in China (Lin, 2011). It was argued that the financial system was important for further economic growth, especially for the development of the private sector or small to medium enterprises, and for encouraging the efficiency of state-owned enterprise (Berger et al, 2009).

2.2 Unbalanced Economic Development in China

During 1978 to 2009, the national average real GDP growth is about 9.5% per annum. However, the growth did not occur equally between provinces. For example, growth rates in the province of Qinghai in the west of the country were 13% lower than in the dynamic south coastal provinces, such as Zhejiang and Guangdong provinces. Qinghai remained amongst the poorest of China's provinces (China Statistical Year Book, 2010). China is divided into seven regions: central and south China (Henan, Hubei, Hunan, An'hui and Jiangxi); the east coast (Jiangsu, Zhejiang, Fujian, Shangdong, Guangdong and Hainan); the north, the northeast, the northwest; and the four municipalities of Beijing, Shanghai, Tianjing and Chongqing. The coastal provinces generally refer to Zhejiang, Fujian, Guangdong, Jiangsu, Hebei, Liaoning, and Shandong. The remaining provinces are referred as inland provinces (Groenewold et al, 2008; Lau, 2010).

Historically, economic growth in the inland provinces was lower than in the coastal provinces. In the first Five-Year Plan (1953-1957), the Chinese government was trying to balance economic development between inland and coastal provinces, through government led investment. The inland provinces accounted for 52% of all government investment at the beginning of the first Five Year Plan but 70% by the end of the third in 1970. Despite the increase in investment in the inland provinces, their GDP per capita was around 0.7 of

GDP per capita nationally during the 1950s and 1960s. In the fourth Five Year Plan (1971-1975), investment in the inland provinces fell but remained above 50%; as a result, the ratio of GDP per capita fell to 0.5 by 1977 (Chen & Groenewold, 2013). The inland provinces had become wholly reliant on government expenditure.

Economic reform was implemented gradually after 1978: firstly, within the coastal cities, such as Shenzhen, where there were special economic zones (SEZs); then to those provinces containing the SEZs; and latterly to the eastern and northern coastal provinces. Major features of economic reform since 1978 have been foreign trade and investment and export orientated industrialization. From 1988, special measures were taken to secure the low wage labour and cheap raw materials that foreign investors sought as a result of their efficiency driven strategies. The Chinese government additionally provided fiscal and financial benefits for FDI, such as tax rebates for exports. As a result, the coastal regions lead national economic growth. China's GDP per capita increased from RMB792 to RMB3631, in 1990 constant prices, during the period 1978 to 1999 (Fu, 2004; State Statistical Bureau of China, 1999). However, inter-provincial growth has not been balanced. During the 1990s, the real GDP per capital increased by only 95 percent in the inland provinces, but by 144 percent in the coastal provinces. In 1999, the average GDP per capita in inland regions, measured using 1990 constant prices, was RMB2497. However, in the same year, the average GDP per capita in coastal regions, measured was RMB5204 (State Statistical Bureau of China, 2000). The income and economic opportunities between the coastal and inland provinces were uneven. Amongst the reasons were favourable government policy, geographical location, access to ports and transportation for an export driven boom, superior infrastructure facilities, and FDI.

Biggeri (2003) considers that FDI is the main reason for the rapid growth of exports, and consequently transformed the coastal regions. In 1999, 91% of China's total exports were from the coastal regions. The major export industries included clothing, footwear, electrical equipment, machinery, and electronic products. Furthermore, export-oriented FDI in labour intensive industries in the coastal regions lead to labour migration from the inland provinces to coastal provinces, enabling the coastal provinces to sustain their growth.

After 1978, the government policy focused on the coastal regions, and the inland provincial regions received limited FDI. In 1992, the Chinese government decided to accelerate economic reform nationwide, gradually creating a market-oriented economy. However, most of the FDI was still concentrated in the earlier developed provinces, and continued to flow there. In eastern coastal areas such as Guangdong and Zhejiang provinces and in major cities such as Beijing and Shanghai, economic growth was consequently rapid. Government investment in the coastal areas rose to 65% of the total by the end of eighth Five-Year Plan (1991-1995). However, in the ninth phase of economic development (1996-2000), the government became concerned about unequal regional development, and decided to shift the focus back to the inland provinces (Chen & Groenewold, 2013).

Since the 11th Five-Year Plan, China's government has aimed to accelerate the economic development of inland provinces. Hunan province is one of these provinces. Compared to the coastal areas, Hunan is an underdeveloped inland province, with economic development restricted by backward infrastructure, low urbanization levels, and poor transportation connections.

Most of these disadvantages are related to low investment. Therefore, the Hunan government focuses on supporting infrastructure construction, public transportation, urbanization, agriculture, and, in addition, regulating local banks to provide loans to small to medium enterprises. In 2006, the Hunan government announced that the top priority should be given to supporting economic and social development (Xian et al, 2013).

2.3 Background to Chinese Banking Sector

As part of overall economic reform since 1978, the banking sector was also subject to change. From that date to 1984, the People's Bank of China (PBC) began to limit itself to a regulatory and supervisory role, and handed over commercial activities to the China Construction Bank, the Bank of China, the Agricultural Bank of China, and the Industrial and Commercial Bank of China, called the State Owned Commercial Banks (SOCBs). A second step was the separation of commercial banking activities from those specially geared towards economic development. To this end, policy banks were established in 1994 in order to take over from SOCBs projects for development purposes, and a new Commercial Banking Law was approved in 1995 to regulate the commercial banks. Thirdly, the new law more clearly stated the objectives of PBC, and its three main responsibilities were monetary stability, banking supervision, and oversight of the payment system. But it did not grant PBC independence from the State Council. Finally, responsibility for monetary policy was separated from banking supervision with the creation of the China Bank Regulatory Commission, in 2003. This section will assess the detail of China's banking reform, the issues and problems of the banking sector, and the use of foreign investors for the transfer of leading management practices.

2.31 The liberalization of China's banking industry

The central bank or People's Bank of China (PBC) was established in 1948, one year before the Communist Party took full control of China, and was the foundation of the socialist banking system. It was a mono-bank model: other banks were taken over by PBC or administered by them. PBC and the Ministry of Finance were the institutions charged with ensuring that national production plans were fulfilled (Ma, 2001). In a planned economy, the bank acted as an intermediary, and made few decisions in the allocation of resources. The government guided all investment and resource allocation. In December 1978, the Communist Party Congress approved the Open Door Policy to achieve economic modernization (Mo, 1999).

The reform of Chinese banks can be divided into four periods (Tang, 2005). From 1978 until 1984, the first reform period, the main task was separating commercial banking from regulatory and supervisory central banking. PBC was still the central bank, but the main tasks were supervision over financial institutions, maintaining price stability, and issuing bank notes. The commercial operations of PBC were hived off into four specialized state owned banks (Jiang et al, 2009). In February 1979, the Agricultural Bank of China (ABC) was split from People's Bank of China (PBC). In March 1979, the Bank of China (BOC) was given greater independence from PBC. The State Administration of Exchange Control (SAEC, now State Administration of Foreign Exchange, or SAFE) was separated from BOC and affiliated with PBC. In October 1979, the China Construction Bank (CCB) transformed from a department of the Ministry of Finance (MOF) to become a bank under the State Council. In January 1984, the Industrial and Commercial Bank of China (ICBC) was established to take over PBC's remaining deposit-taking and lending functions. Since 1984, PBC did not have commercial bank functions.

Although it was as a central bank, it did not act as would a central bank in market-oriented economies (Yang, 2002). PBC was a directly responsible to the State Council, and it was consequently required to manage the funding of SOEs and government projects.

The Bank of China (BOC) became mainly responsible for foreign currency transactions and the financing of foreign trade and investment. The Construction Bank of China (CBC) looked after government's fixed asset investments, mainly large urban construction projects. The Agricultural Bank of China (ABC) was mainly responsible for rural areas, agricultural sectors, and the network of rural credit cooperatives (RCCs) that had been providing small-scale rural banking. The Industrial and Commercial Bank of China (ICBC) looked after commercial banking activities in urban areas and manufacturing (Lin & Zhang, 2009). The four specialized state owned commercial banks were only allowed to operate commercial services in their designated sectors.

The four commercial banks set up level-one branches in each provincial administration of government, and each branch managed its own business within its designated region. The headquarters allocated the amount of loans and resources to be used in each branch. Business decisions were not based on commercial considerations, and the banks mainly provided services to SOEs and infrastructure projects under government control. There was still no competition among them since they were policy-lending 'conduits' and lacked any incentive to compete. As a result, the four SOCBs accumulated large stocks of non-performing loans. In the meantime, the Chinese government gradually opened more cities to inward investors. By the end of 1984, Chinese government had opened 14 cities to foreign capital, in addition to the existing four SEZs, most of which went into manufacturing (Leung, 2000).

The second reform period was between 1984 and 1994. The key objective was to transform the policy-driven banking system into a market-oriented one. The government removed restrictions on the four specialized state owned commercial banks, and allowed them to operate commercial services in all sectors (Fu & Heffernan, 2009). Since the mid-1980s, business restrictions on the four state owned banks were gradually loosened: the situation was described as 'BOC is landing home, ABC is entering into cities, ICBC is going to villages, and CCB is coming into enterprises' (Shang, 2000; Okazaki, 2007). The four commercial banks were established with the purpose of restructuring and building a more effective banking system. In order to increase competition, the Chinese government encouraged the establishment of joint-stock commercial banks (JSBC), with a range of shareholders, but with the majority still remaining with government institutions or government owned enterprises. The Chinese government gradually allowed the establishment of new 'small and medium sized' local commercial banks to provide services to individuals and to small and medium sized urban firms. Between 1985 and 1992, new commercial banks included the Bank of Communications, the CITIC Industrial Bank, the Shenzhen Development Bank, the Guangdong Development Bank, the China Merchants Bank, the China Everbright Bank, and the Hua Xia Bank. Also, urban credit cooperatives were established, and a more diversified banking system catered better for individuals and SMEs (Girardin & Ping, 1997). In 1990, stock exchanges were created in Shanghai and Shenzhen. By the end of 1992, there were 9 JSCBs, 12 insurance companies, and 387 trust and investment companies. The Chinese government opened 714 cities, in about a third of the provinces, for foreign investors. It restricted foreign banks to certain businesses, and their basic function was to introduce overseas funds to support foreign enterprises in China (Wong & Wong, 2001).

However, during the 1990s, state guidance and influence ensured that the banks supplied the financial requirements of state-owned enterprises, which felt little incentive to pay back their debts, thereby leading to huge levels of non-performing loans. The government helped those banks in financial difficulties to write-off bad loans, or routinely it paid off any outstanding debts up to a half billion Yuan; larger amounts required approval from the State Council (Cull & Xu, 2000). Therefore, Chinese banks had no incentive to compete with each other. In summary, SOBs were not independent from government-set policies and could not make their own lending decisions (Bonin & Huang, 2001).

After the 14th National Congress of the Communist Party of China (CPC) in 1992, the government formally set out plans for developing a 'socialist market economy', and, consequently, further reforming the banking sector. The State Council issued its Resolution on the Financial System Reform, in December 1993, and declared its agenda for the reform of the financial system: (1) the establishment of an independent body for macro-economic management by the PBC (under the direction of the State Council, but independent from local governments); (2) the founding of policy banks; (3) the transformation of state-owned specialized banks into commercial banks; (4) the development of open, competitive, and well-managed financial markets; (5) the reform of foreign-exchange controls; (6) the issuance of guidance for the emergence of non-bank financial institutions; and (7) the promotion of a financial service infrastructure and system (Wu, 2005).

Then, in the third period of bank reform from 1994 to 2001, the main tasks were removing the restrictions on the state-owned specialized banks, permitting them to operate in all areas of banking and encouraging inter-firm

competition. The objective was to transform banks into market functioning and profitable organizations. In 1994, the Chinese government established three policy banks, which were the Agricultural Development Bank of China, the China Development Bank, and the Export and Import Bank of China to take over the long-term development finance and policy-based lending previously performed by the four state-owned banks (Chang, 2010). The 1995 Commercial Bank Law officially confirmed PBC as the central bank, and directed the state-owned banks to become 'commercial banks'. The legislation provided the legal basis for the restructuring that created the SOCBs, and regulated that they were responsible for their own profits and losses. It encouraged the investment of foreign banks, and the establishment of regional joint stock commercial banks as a tool for increasing competition and accelerating the reform of the industry (Chen & Thomas, 1999).

The SOCBs still had to deal with a large number of non-performing loans (NPLs), and the government drew up plans to clear their balance sheets. In March 1998, the National People's Congress designated financial reform as one of three policy reform goals for the next three years. The Congress's Standing Committee of the National People's passed a plan submitted by the State Council to issue special government bonds that would be used to inject capital into the SOCBs. At the end of 1998, Chinese government transferred more than RMB 1.4 trillion in bad debts held by the SOCBs to four state-owned asset management companies (AMCs) (Yeung et al, 2012). By the end of 2001, the two-tier banking system almost took shape, with the People's Bank of China at one level, the policy banks and state-owned banks, joint-stock commercial banks, local commercial banks and foreign banks at another level. However, Chinese banks still suffered high levels of non-performing loans and low returns on investment and business practice was slow to change, due to they supported the restructuring of more than six thousand SOEs, provided

RMB 800 billion of policy loans, and lost RMB 316 billion from their loans during 1995 to 2002 (Ping, 2005).

The fourth period of banking reform occurred from 2002 onwards. After joining the WTO in December 2001, China was committed to opening up the financial and banking system completely within five years, necessitating the acceleration of reform. The Chinese government had the Second National Financial Work Conference to consider how to build an efficient, financial system in 2002. The conference defined several problems, which were the incomplete supervisory system, the inefficiency of financial institutions, a weak legal framework to protect and regulate the rights and interests of financial institutions, a lack of employees with specialized financial knowledge and skills, and low technological innovation (People's daily, 2002). In 2003, the Chinese government established the China Banking Regulatory Commission (CBRC) to oversee industry regulation and the process of reform in Mainland China, excluding therefore Hong Kong, Macau and Taiwan. The objectives were to protect the interests of depositors and consumers through prudential and effective supervision; to maintain market confidence; to enhance public knowledge of modern finance through customer education and information disclosure; to combat financial crimes; to promote financial stability and facilitate financial innovation; to enhance international competitiveness; to set supervisory and regulatory boundaries, and refrain from unnecessary controls; to encourage fair and orderly competition; to clearly define the accountability of both supervisor and supervised institutions; and to employ supervisory resources in an efficient and cost-effective manner (CBRC, 2005c).

As government policy in practice left SOCBs with intractable debts, by the end of 2002, 51.2 per cent of some 62,000 SOEs had failed to repay bank loans

(Luo, 2003). In October 2003, at the Third Plenary Session of the 16th Central Committee of the China CPC, it was officially permitted to change SOCBs' ownership structure, and to further reform Chinese banks. The Central Leading Group was established to plan for their reform, and to improve corporate governance and management efficiency. The government used four means to restructure the SOCBs: capital injection, granting the banks approval to issue subordinated bonds to supplement their capital, the disposal of NPLs through Asset Management Companies (AMCs), and permitting the introduction of foreign strategic investors. Chinese banks needed to reduce redundant employees and to close unprofitable branches. Although the Chinese government had established policy banks, the SOCBs still needed to provide credit for public projects, through guidelines from the CBRC. In December 2003, the Chinese government began the second capital injection to SOCBs. It established the Central Huijin Investment Company (Huijin), funded from the earnings and reserves of the State Administration of Foreign Exchange (SAFE). The main shareholders in Hujin are SAFE, the PBC and Ministry of Finance (Cheng et al, 2006). In an uncertain and unstable environment, Huijin was expected to become an influential shareholder of SOCBs and to urge them to improve their corporate governance and generate profits. Many of Huijin's key personnel came from the PBC Financial Stability Bureau, and Huijin's president, Xie Ping, was the former director-general of the Bureau. In December 2003, Huijin injected US $45 billion into BOC and CCB. Then, it provided RMB 3 billion for Bank of Communications in June 2004, and US$ 15 billion for ICBC in April 2005. Huijin injected RMB499.6 billion (US$60.40 billion) into BOC, CCB, ICBC and BOCOM in total, and it offered official foreign exchange reserves (chiefly as U.S. dollar investment) and borrowing (in Renminbi) (Wang, 2004). The Chinese government through Huijin still exercised indirect control over the major state-owned banks. For example, it held over 50 per cent of ICBC shares (Shih, 2005).

In order to accelerate the reform of state owned banks, since 2005, the Chinese government transformed three SOCBs, allowing a minority foreign ownership, and enabling them to go public with part of the shareholding. CCB and BOC were listed on the Hong Kong stock market, in 2005 (Berger & Zhou, 2009), and BOC appeared on the Shanghai stock market in 2006. In the same year, ICBC was listed both in Shanghai and Hong Kong. It was expected that listing would bring or imply a better corporate governance structure since the stock exchange rules necessitated internal changes and some public scrutiny. The Chinese government would try to attract foreign investors to promote international standards and 'best practice', although the CBRC restricted foreign banks to selected banking activities in specific locations. Listing moreover enabled foreign investors to purchase the shares of Chinese banks. A cap of 25% of total shares in any domestic bank could be sold to overseas interests, with any one investor allowed between 5% and 20%, subject to regulatory approval (Zhang, 2005). These deals were consummated in 2006. While banks opened up to foreign investors, they went public with sales of shares through their IPOs, while retaining their majority state owned bank status. Three of the Big Four that took on minority foreign ownership promoted very large IPOs soon afterwards.

Even after several efforts at reform, the change agenda remained lengthy: corporate governance and supervision; greater reliance on market forces and profit goals; and a more supportive legal system and improved asset quality (Hope & Hu, 2006). The governance structures of Chinese banks remained a topic of concern. There are too few independent directors, and a paucity of effective board committees, particularly those for risk management and audit. Whether financial statements in China reflect realities are questionable, and are usually substantially short of international standards. The CBRC and Chinese government tried to attract foreign investors to help improve the

corporate governance of Chinese banks. While foreign partners might help to improve governance, their limited representation on boards and their lack of influence on management decisions inevitably restrained their impact. One aim of improved governance is to enable decisions based on commercial considerations, rather than being influenced by government or bureaucrats. CBRC introduced a requirement for independent, executive boards to oversee the work of senior management. Another important element of reform is building the legal and regulatory system for banks, but uncertainty for the industry continues. In which case, banks remained reluctant to lend extensively to private enterprises. Even where banks are able to lend against collateral, pursuing claims in the event of default is expensive and time consuming, and offers no guarantees of success. Better performing financial markets need significant improvements in the wording of the legal code and in its enforcement. Finally, the CBRC has the powers to enforce changes in organization and practice on the banks, in the interests of reform, but the dilemma is that the needed use of such powers runs counter to the notion of banks themselves making decisions in response to market forces.

One of the big issues during the progress of Chinese bank reform has been dealing with non-performing loans. In 1997, the proportion of non-performing loans reached 24 percent of the total loans held by the four state owned banks (Dai 1998; CCER 1998). The total outstanding loans were Yuan 6,610 billion for all state commercial banks during the mid-1997. The total bad debts were Yuan 317 billion, which was more than the banks' total net assets. About 5 per cent of their deposits were held by government organizations and 25 per cent of their deposits were held by SOEs, and so the banks were not in a position to pay out these deposits if requested (Huang, 1998).

One of the important tasks for banking sector reform was clearing up poor balance sheets. One of the ways for the Chinese government to support the Chinese banks in reducing non-performing loans was capital injection. In 1998, the PBC required Chinese banks to improve their assets and liabilities management practices. In this year, the total amount of capital injection to Chinese banks was RMB 270 billion (US$ 32.5 billion), which was about 3 per cent of China's GDP or 55 per cent of central government annual revenues (Green, 2005). In the meantime, the MOF helped SOCBs to issue bonds as a way of obtaining a capital injection (MOF, 2006).

In 2003, the Chinese government established the Central Huijin Investment Company (Huijin), using foreign exchange reserves held by the State Administration of Foreign Exchange (SAFE). In total, Huijin injected RMB 499.6 billion (US $ 60.4 billion) to the four banks (BOC, CCB, BOCOM and ICBC). In December 2003, it provided US$ 45 billion to BOC and CCB. In June 2004, it issued RMB 3 billion to BOCOM, and, in April 2005, it injected US$15 billion into ICBC. Another round of capital injection started from January 2004. The PBC used its international exchange reserves to assist BOC and CCB and divided US$45 billion equally between them. Similarly, Huijin provided US$15 billion and the Ministry of Finance another US $15 billion to the ICBC. Furthermore, ICBC's balance sheet was boosted by another US$85 billion from other AMCs and other public sources (Hope and Hu, 2006, MOF, 2010). In January 2004, the PBC gave another US $45 billion to boost the capital adequacy ratios of China Construction Bank and Bank of China, clean their balance sheets, and allow them to list their shares on the stock market. Since January 2005, the PBC and the CBRC also coordinated with various levels of local government to help write off the bad loans of local commercial banks, and to close down some insolvent local banks and credit cooperatives (CBRC, 2005d).

One of the key reasons for large amounts of capital injection into Chinese banks during 2003 to 2005 was preparing for public listing. From 2005 to 2007, CCB, BOC, ICBC and BOCOM were listed on stock exchanges. Initially, the Chinese government wanted the banks to be listed in the Hong Kong stock market, as they recognized that the standards for qualification and disclosure would be more strict than in a domestic market and at recognized international levels. Also, the Shanghai stock exchange market was sluggish from 2001 until 2005 (Shanghai Stock Exchange, 2005). Therefore, both CCB and BOCOM listed on the Hong Kong stock market. However, the move was criticized for not giving opportunities to the domestic investor. Therefore, later on, both BOC and ICBC listed in Hong Kong and Shanghai, and CCB and BOCOM too offered shares in Shanghai.

When the four state banks were preparing for listing, the MOF wrote off all NPLs held by BOC and CCB, which made Huijin their largest shareholder. However, the MOF did not write off all of the NPLs at ICBC, although the MOF and Huijin are its largest shareholders. Therefore, in practice, the MOF still has indirect control over major state owned banks through Huijin or, in some instances, direct control.

The Chinese government established four asset management companies (AMCs) to help with bank NPLs. The capital of AMCs was mainly from the MOF, the PBC, and their bond issues. Formally, the AMCs operated independently, but had only one shareholder, which was the MOF. The MOF allowed each AMC to deal mainly with one SOCB. Due to most of the employees being originally from the four state owned banks, AMC personnel largely handled the NPLs of their former banks. By the end of 1998, the total amount of NPLs purchased by AMCs from SCOBs was RMB 1.4 trillion, which

was 21 percent of the loan balance of the SOCBs. From 1999, those NPLs were transferred to the four AMCs (Cinda, Huarong, Great Wall, and Orient). The loans, worth $168.2 billion, have been written off, as far as the Big Four are concerned (CCER, 2000).

The four state owned asset management companies took the main part in the restructuring of non-performing loans at Chinese banks. According to the regulations on the practice of debt-for-equity swaps, issued in 1999 by the China Economy and Trade Commission and the People's Bank of China, Chinese banks needed to transfer their non-performing loans to the AMCs (Luo, Zhang and Zhu, 2011). The Ministry of Finance and the PBC launched "The guideline for better practice of debt-for-equity swap in state owned enterprises" (2003). The MOF regulates that the four AMCs could engage in a broader range of asset management activities, rather than providing support for SOEs. In addition, the MOF sold a minority interest in the AMCs to selected domestic investors.

In the late 1990s, in order to deal with non-performing loans, the Chinese government made efforts to improve the loan classification system. China's State Council decided to classify bank credit assets by international standards in order to improve loan quality and financial risk management. In 1997, the Chinese government put loans into four categories based on the time run for overdue payment, which were "normal", "overdue", "inactive", and "loss" (Huang and Yang, 1998). In 1998, the MOF issued Chinese banks worth Yuan 270 billion (US$33 billon) to help them recapitalize and restructure. Later on, in 1999, the PBC produced a new set of guidelines and further classified loans into five categories, based on their financial risks, which were "passed", "special mention", "substandard", "doubtful", and "loss" (CCER, 2000). From

that date, four state asset management companies have taken over 1.4 trillion Yuan (US$169 billion) in bad debts from Chinese banks. By the end of 2002, the NPLs of the big four banks were 2.6 trillion yuan (US$300 billion), which still accounted for 23.7 percent of their total loans.

The legal situation in China has improved, particularly since the late 1990s, when it revised its legal system in order to join the WTO. However, changes to the laws and regulations did not keep pace with the needs of economic reform and development. In terms of the Chinese banking sector, there were problems such as an inadequate credit registry, the enterprise insolvency law, weakness in criminal liability investigation for financial frauds and irregularities, and the legal framework governing financial institutions and business. For example, China issued the Provisional Enterprise Bankruptcy Law in 1986, implemented from 1988 onwards. However, the law only covered SOEs, and there were no regulations and solutions for private firms facing bankruptcy. Even so, the implementation of the Law was not effective, even for SOEs. Fu and Heffernan (2009) state that one of the reasons leading to the low efficiency of Chinese bank reform was the lack of clarity about bankruptcy procedures, which resulted in large amounts of bad debt to SOEs. During SOE reform, there was neither effective regulation nor a legal framework to guide their restructuring. The Chinese government continued to over-rely on state owned banks to provide loans to indebted SOEs, and then used the AMCs to write off NPLs for Chinese banks.

As a result, the National People's Congress approved a new Enterprise Bankruptcy Law in August 2006, and implemented it in June 2007. The new version of the bankruptcy law covers both SOEs and private firms. It also covers Chinese companies operating overseas and foreign companies

operating in China. Herd, Pigott and Hill (2010) state that the implementation of the reformed bankruptcy law was more effective than previously. The law provides clearer guidelines on the conditions for listing on the stock exchange, as well as clarifying the governance structures and the responsibilities of directors, senior management and key committees. The revised law has the aim of bringing China's financial markets into international practice.

One key objective of the reform process initiated by the CBRC is to formulate appointments and procedures, and to make decisions based on performance. In other words, it seeks to replace the established practice of 'guanxi'. Guanxi is an important form of relationships when doing business in China (Yang, 1994; Xin & Pearce, 1996; Luo, 1997). Jacobs (1979) states that 'guanxi' has a strong influence on Chinese life and society, and complicates its social environment. He further states that guanxi is a set of 'particularistic ties' rather than a 'relation' or 'relationship'. Lo & Otis (1999) argue that guanxi reflects the political culture and personal networks. Therefore, with so many arguments about 'guanxi', it has both positive and negative connotations. Some people might connect guanxi with corruption and bribes, which historically have been prominent in China's social system (Fan, 2002).

Yeung & Tung (1996) contend that 'guanxi is the establishment of a connection between two independent individuals to enable a bilateral flow of personal or social transactions'. There are different types of 'guanxi' between family, friends and businesses. In this research, it refers business to 'guanxi' as related to business (Fan, 2002). Fock & Woo (1998) consider that 'guanxi' is a source of sustainable competitive advantage, as does (Tsang, 1998). Davies et al, (1995) argue that people who have a good guanxi network are assisted in gaining information from government, and that guanxi can improve

the efficiency of firms. However, Tsang (1998) argues that building 'guanxi' could be time consuming and high in costs. In order to build or maintain 'guanxi', firms need to provide certain benefits to people in their network (Fock & Woo, 1998). For example, they may have to pay the expense of trips under the guise of training (Tung & Worm, 1997). Some argue that guanxi is a form of bribery or unfair competition (Fan, 2002; Dunfee & Warren, 2001). Cateora & Graham (1999) state that building guanxi in China costs about 3-5% of operating costs, or even more. Fan (2002) argues that there is no guarantee of success in business when investing time and money, and that guanxi can be seen as an investment. Tung & Worm (1997) believe that guanxi is based on personal contacts, rather than with a firm overall, and that guanxi will be difficult to retain once the relevant person has left the company. Guanxi could be unstable, particularly in relations with government, when public officials leave their positions, and the guanxi will no long exist. As we will see form the cases in the thesis, there is a tension between the procedural and performance related goals of the CBRC and the fact of the continuation of 'guanxi' practices.

The purpose of Chinese bank reform was to lift control by government, and to enable management to make decisions in response to customer needs, as anticipated in a modern banking system. Management would bear the responsibility for allocating credit and offering loans with a view to generating profits and acquiring the best techniques for acquiring and assessing clients. To date, Chinese banks are still obliged to serve different classes of borrowers, under the guidance of the CBRC. Banks continue to be reluctant to take advantage of any operational flexibility they have been granted to vary lending rates in line with the risks and costs associated with different classes of borrowers. The AMCs have been allowed to compete for the management of NPLs built up by banks, and measures introduced in August 2005 gave the

PBC power to take on intractable debts. The creation of capital markets was meant to multiply the sources of finance, and serve the requirements of institutional investors, enterprises and government. Commercial banks were not allowed to purchase bonds from the government, policy banks, or AMCs, since they were needed to cover the banks' NPLs. They were no longer obligated to issue loans to infrastructure companies or provincial or local governments.

2.32 The structure of Chinese banking industry

A comprehensive and multi-layered banking system has taken shape (as indicated in the Figure 2-1 below), which is guided by the People's Bank of China and China Banking Regulation Commission, and operated by the domestic commercial banks (Wong & Wong, 2001). There are further non-bank financial institutions, such as trust and investment companies, and rural and urban credit cooperative societies, as well as foreign financial institutions.

Chinese banks have been gradually reformed, and moved towards operating without being directly government-owned. However, the Chinese government still indirectly controls the banking sector through the China Banking Regulatory Commission, the People's Bank of China (PBC) and the Ministry of Finance (MOF). The PBC mainly formulates and implements monetary policy. The CBRC is the main institution to oversee and supervise the overall operations of Chinese banks. The MOF mainly formulates and implements China's fiscal policies and the central government's budget; draws plans for the issuance of treasury bonds and other government debt; formulates and implements accounting regulations for business; and conducts research on

China's economy and its fiscal situation. Although the MOF no longer has authority to intervene directly in Chinese banks or other financial institutions, it could still have influence through its ownership of shares. In addition, there is the State Administration of Foreign Exchange (SAFE), which mainly supervises and monitors foreign exchange transactions in China.

PBC and the CBRC share responsibility for the regulation and supervision of banks, asset management companies, trust and investment vehicles and deposit-taking financial institutions. The People's Bank of China has the task of formulating and implementing monetary policy (including minimum reserve requirements, interest rates, money supply targets and exchange rates) to ensure the stability of the financial system. Its tasks are to restrain inflation, maintain growth rates, bail out illiquid financial bodies, and regulate deposit-taking institutions, and it reported directly to the State Council. Among its duties, the last has often been overlooked, because PBC has focused on inflation and growth. The CBRC, when established, was charged with formulating the rules and regulations that would govern banking institutions in China. At its founding, it took several actions to promote the reform and restructuring of Chinese banks, particularly the big four state owned banks, and it helped to attract foreign investment. The CBRC was created to fill a need for specialized regulation of an increasingly complex banking system that was to be fully opened to foreign financial institutions before the end of 2006. Also, the CBRC encouraged domestic and private investors to buy shares in banks as part of its strategy to improve their corporate governance, thereby improving their operational efficiency. The CBRC similarly introduced measures to deal with the dysfunctional rural credit cooperatives and to develop rural (and city) commercial banks.

The three policy banks - the Agricultural Development Bank of China, the China Development Bank and the Export-Import Bank of China – had been formed previously, in 1994, in order to take over functions from the new state owned commercial banks. Three state policy banks are mainly responsible for government projects. The domestic commercial bank sector includes five stated owned commercial banks, and national and local commercial banks. As we have noted, the state owned commercial banks - the Bank of China (BOC), the China Construction Bank of China (CCB), the Agricultural Bank of China (ABC), and the Industrial and Commercial Bank of China (ICBC) – were created out of what were the four major business divisions of the PBC. The aim was to make them compete in every aspect of banking, and to make them responsible for their own profits or losses. The China Post Savings Bank is the fifth largest state owned bank, and it was established in 2006. The majority of national and local commercial banks were established during the late 1980s or the early 1990s.

From Figure 2-1, we can see the overall regulatory structure of the Chinese financial services industry and its various divisions. We can see, from Figure 2-2, that our five case studies fit under the category of 'Domestic Commercial Banks', and that the nature of their original ownership structure and the geographic reach of their operations at the next level differentiate them.

Figure 2-1: Structure of the Chinese Banking System

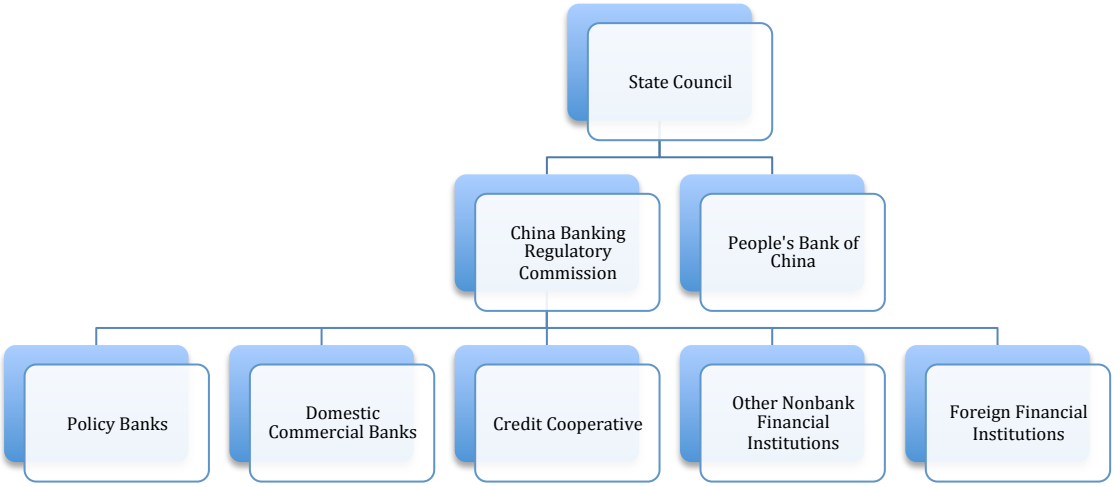
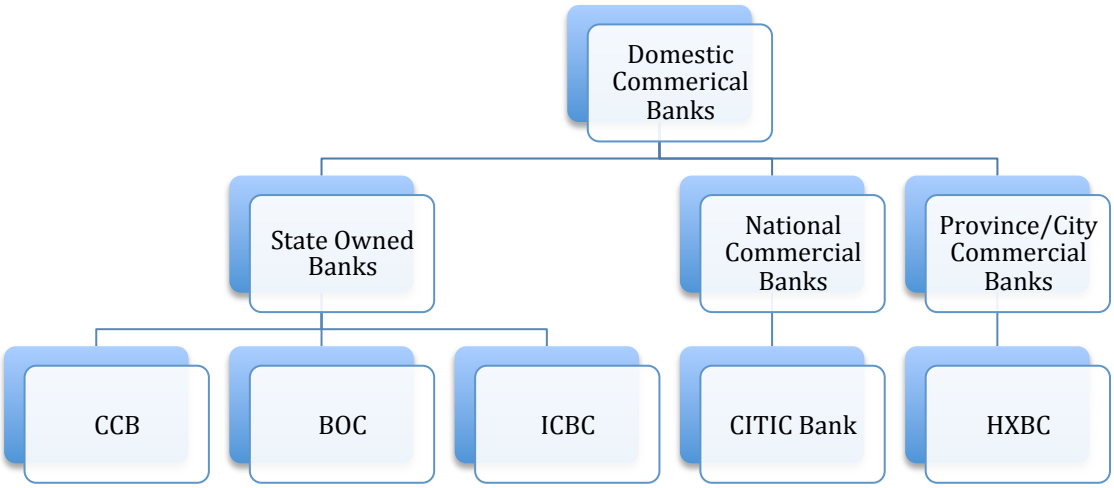


Figure 2-2: Structure of Domestic Commercial Banking Sector in China, and the Five Cases Studies



2.33 Foreign investment in Chinese banks

In 1979, the Chinese government would only permit foreign banks to open representative offices in China. By 1982, it allowed inward investors to operate branches within Special Economic Zones, most obviously in Shenzhen. In

1999, foreign banks in that city could expand their business into provinces such as Guangxi or Hunan, with restrictions being progressively relaxed (Lin & Xu, 2007). Yet, in order to maintain national economic independence and to protect domestic banks from strong competition, the Chinese government maintained restrictions on foreign banks (He & Fan, 2004).

Since China joined WTO, and promised a further opening-up of the financial sector, many foreign banks attempted to expand their business activities. Their entry brought competition (since foreign banks have advanced technology, managerial skills, superior corporate governance and risk management procedures) as well as opportunities (foreign banks had to seek joint ventures with domestic firms) (Allen et al., 2006). Capabilities might be transferred to Chinese banks through minority foreign ownership, and ultimately facilitate the removal of tight state control of the industry.

Foreign investors looked to access an expanding Chinese market through strategic alliances with local businesses, by selling credit cards, fund management, trustee services, insurance, and other products through their partners' branch networks. Both parties had to commit themselves to a mutually beneficial partnership, but the objectives of foreign investors, Chinese banks and Chinese government might be different.

After China joined the WTO, in order to protect the domestic banks, the PRC regulated that foreign banks needed to have a minimum of 1 million RMB deposits. Even in this case, foreign banks were still willing to register this amount of money and easily met the conditions. Foreign banks enjoyed the benefit of a preferential 15 per cent income tax rate until a new corporate tax

rate of 25 per cent was introduced for all domestic and foreign firms in 2008. The CBRC stated that a foreign investor could only hold up to a 20 per cent share of a Chinese bank, and it did not permit any significant share in more than two Chinese banks (CBRC, 2005b). Therefore, before investing, foreign multinationals would carefully evaluate the bank's financial position, the scope and nature of its operations, and the management of its portfolio and risks. Any investor would analyse operating and funding costs, and the soundness of provisioning practices and loans. It would form a view of the bank's key officers and their expertise, and assess the likely benefits of training and hiring other staff. Multinationals have therefore two entry strategies: investment in a 'greenfield' bank without a history of dubious assets, or in one of the big SOCBs on the grounds their extensive distribution networks counterbalance issues of NPLs and weak governance. They might, additionally, take an intermediate approach.

Greenfield banks, such as Bohai Bank, more easily adopt international best practices, yet they have limited branches and distribution network. For joint-stock banks and city commercial banks, there are fewer legacy assets, small capital commitments, faster growth, better governance, more transparency, and potential flexibility in the sharing of management control. However, these banks have a limited franchise and distribution network if compared to the big national commercial banks. Other common drawbacks are complex shareholder structures and difficult decision-making processes, plus unrealistically high price expectations and tougher negotiation positions. In the case of the Big Four, they have advantages in their immediate access to extensive nationwide distribution systems, as well as meaningful strategic cooperation in attractive business segments such as credit cards or consumer finance), They can significantly escalate an investor's position in China through a single investment. On the downside, they have huge legacies in

asset quality and wieldy operational systems. Foreign investors would require large capital commitments to gain a meaningful stake, face uncertainties about their ability to influence management decisions, and cope with political sensitivities about protecting a national franchise.

Most forms of international finance have shown an interest in investing in China, including universal banks, commercial banks, specialty finance companies, asset management firms, and insurers. Their objectives differ, as do the advantages and disadvantage they bring to the Chinese finance industry. Universal banks refer to those engaged in a wide range of financial services, such as consumer banking, commercial banking, investment banking, asset management, and insurance, and as exampled by Citigroup, HSBC, and J.P. Morgan Chase. They can offer Chinese banks a broad range of strategic and operational benefits, and impressive financial and client resources. Universal banks would make protection of their own brand and reputation a priority. For example, when in 2004 HSBC invested in the Bank of Communications, the fifth largest bank in China, it took a 19.9 per cent share. HSBC took two board seats, and helped to initiate a credit card business, with a plan to establish a credit card joint venture subject to regulatory approval. Citibank invested in Shanghai Pudong Development Bank, the ninth largest Chinese bank, with its franchise concentrated in the Shanghai region, and gained a 5 per cent share. Citibank similarly had board representation, with the goal of applying for a credit card joint venture, and transferring best practices in risk management, IT, and marketing. A possible concern is conflict of interest as many of their products and services will overlap and potentially compete with their Chinese partners.

Commercial banks are mainly focused on corporate and consumer banking, and on wealth management. For instance, the Bank of America has invested in CCB, and the Royal Bank of Scotland in Bank of China. Specialty finance companies deal with services from credit cards and consumer finance to commercial finance and leasing. The scope of their activities is narrower than that of the banks but they consequently have specific expertise. Ford Motor Credit, General Electric Capital, General Motors Acceptance Corporation, and MBNA Corporation are all prominent, and American Express invested in ICBC. Speciality finance companies could assist with product innovation, profitable niche products, and marketing.

Asset management firms - such as Capital Group, Fidelity, Franklin, and Putnam - have expertise to complement the services supplied by the major Chinese banks. For example, Pangaea Capital Management invested in Huaxia Bank. Asset management is an under-developed business in China. These firms will not offer additional financial resources, and possess limited capacity to assist Chinese banks in restructuring themselves as competitive commercial banks. Insurers such as Aviva, ING and Prudential have looked for distribution networks in China, and Allianz invested in ICBC. Their primary contribution would be to develop new streams of revenue, but they would have little influence on bank reform.

Chinese banks would also consider criteria in their choice of foreign partners: profile, strategic fit, management and cultural fit, core competencies, appetite for acquisition, and capital funds (see Table 2-1 below).

Table 2-1: Criteria Used by Chinese Banks in Selecting Potential Investors

Categories	Criteria	Relevancy and Benefits
Profile	Asset size; market capitalization; financial strength and credit ratings	Strong world-class profile, experience and branding reputation
Core competencies	Business mix: retail banking, corporate banking, risk control, wealth management Competencies in information technology, management information system, improving operating and financial performance, and in combining competencies	Availability of international best practices Tangible benefits to Chinese banks in execution of strategy
Acquisition appetite	Mergers and acquisitions experience in financial services industry Experience in minority stake investments	Interest in committing to investment in Chinese banks Willingness to negotiate reasonable terms

Adapted from Hope & Hu (2006)

In summary, Chinese banks tend to look for partners that can provide them with improvements in product development, technology innovation, marketing skills, and distribution expertise. The Chinese bank also looks for partners who have superior management capabilities and expertise in core competencies, and partners that will minimize the potential for conflict and damaging competition between them.

The Chinese government and foreign investors seem to agree that engaging the expertise of international strategic partners has the potential to improve Chinese bank performance, including the control and management of operations, the introduction and marketing of new products and services, and the enhancement of asset quality and better management of risk. While foreign banks have competed for customers through quality of service and efficiencies, Chinese domestic banks traditionally took on the task of resource allocation under the guidance of government, and had limited competition with each other. Therefore, Chinese banks had little incentive to prioritize providing customer service, but current regulations state that they are responsible for their profits and loss (Jia, 2009). As they gradually accepted the importance of customer service, they realized that strategic alliance with a foreign partner might help them to make rapid gains. Moreover, it was considered that foreign banks had the experience of innovating and developing a wide range of products to meet the needs of different customer groups. It was assumed that within a decade China's middle class would be a large and influential market, but Chinese banks have limited experience of competing in retail services. Moreover, foreign banks could strategically offer a focus on the highly lucrative market private banking business and on the means to develop these services effectively.

A major contribution to core competence can come through the direct transfer of skilled and experienced managers and technicians from the foreign investor. Staff can learn first hand how an international financial institution deals with all aspects of lending, funding, training, or containing risks. In addition, the multinational can provide advice on and support for information systems and technology. Through their participation in the business activities of China's domestic banks, multinationals can transfer knowledge and help to build skills in marketing and product development. They will be able to assess the need

for specialized recruitment and training, and, if permitted, they can demonstrate how governance structures might function in a market-oriented commercial bank.

However, there are limits to the number of such personnel in the employ of foreign partners and limits on the number willing to work in another company overseas. Language barriers will be a difficulty for those on long or short-term secondment. Visiting personnel may operate only in the headquarters of Chinese banks, and not at the operational branch level. Yet the nature of banking, the development and delivery of services may be determined by the very specific interaction with customers and by locally determined requirements, and competitive success is closely connected to building client networks. Foreign personnel in Chinese banks have normally been found in information technology, product development, and design departments and most frequently at the headquarters. In which case, training according to bank headquarters or CBRC guidelines to ensure that the skills and types of employees are available for the new services and systems being introduced is paramount. The extent to which this top-down transfer of practices and personnel development encourages or inhibits managerial initiative at the level of the branch is open to question, as is the ability of banks to evolve services suited to the economic and customer needs of such varied Chinese provinces.

East Asian governments have used offerings of stock in state-owned companies as a way to secure additional capital. Better performance through improved governance of publicly listed companies has been at best an afterthought, and little concern has been shown for the interests of minority shareholders. China has been no exception to this general pattern. But, in the case of strategic investors in banks, the government has been interested in

boosting performance through the transfer of capabilities in human resources, risk assessment, information technology, marketing, and product development. The amount of money injected in share acquisitions has been substantial, especially for HSBC's buying of 19.9 per cent of the Bank of Communications (US$1.75 billion), and Bank of America's 9.1 per cent of CCB (US$3 billion). Entering into a strategic partnership with a foreign bank can do much to enhance the public image of the Chinese enterprise. Despite their huge size, the four main SOCBs are not well known outside China, and interactions with large multinationals could augment their global profile too. CITIC Banks made advances Latin Americans with the cooperation of BBVA.

2.4 Multinationals, Capability Transfer and FDI Theory

As we have seen, the open door policy introduced after 1978 prioritized the liberation of economic planning and greater use of market mechanisms in order to transform the level of China's manufacturing nearer to global standards. Government policy focused, too, on the most developed, coastal provinces, and, initially, given low domestic wages and low demand at home, it targeted export markets. In order to transform its manufacturing, it decided on a policy of allowing inward FDI, and, at first, insisted on joint venture arrangements with state-owned enterprises in order to bring about the transfer of capabilities in products, processes and technology. Uneven national economic development, mass internal migration and low levels of home consumer demand were amongst the range of side effects. The next phase in government policy is seeking to address all these three outcomes, and, moreover, on improving the performance and competitiveness of the service sector, most notably banking. Since the mid-1990s, following its previous approach to manufacturing, the government in Beijing has eased controls over the banks, and, from 2003, it allowed foreign multinationals to invest and form

strategic alliances with indigenous enterprises. For two reasons, however, we should not assume that the approach adopted for manufacturing will or can be the same in the case of banking. The first reason is that, although there have been significant changes in the regulation of the industry, the government retains tight supervision of the banks, and, so far, the scale of multinational investment in individual concerns has been very limited. The second reason is that there may be fundamental questions, in FDI theory, about the differences between manufacturing and services, and in the nature and extent of international capability transfer between the two sectors. The remainder of this chapter will, therefore, review ideas about multinationals and their impact on host economies, and explore what lessons can be taken from FDI to illuminate recent changes in China's banking industry.

It will be important to analyse the motivations and rationale of foreign direct investment, which has been used to explain the 'miracle' of Chinese manufacturing success in the developed coastal provinces of Guangdong and Fujian, but provides only partial explanation for a service industry in the less developed inland provinces. We should not assume that China's next stage of economic development would be achieved with the same approach or means. This chapter looks at FDI theory in service industries in particular, and how it differs from FDI theory in general. It subsequently discusses FDI in the Chinese banking industry. It focuses on how to transfer the ownership advantages of MNEs to Chinese banks, and to what extent Chinese banks can learn from MNEs to enhance competitive advantages.

2.41 Ownership advantage and monopoly

Hymer (1960) argues that the mere transfer of capital funds could not fully explain the overseas operations of firms. He was one of the first analysts to

identify MNEs as a special category of business, and he states that, to succeed in overseas markets, MNEs must have some 'ownership advantage' in technology, product or management that allows them to overcome the problem of being foreign. He points out that firms do just send capital across borders, but must invest heavily in personnel and organization, making FDI an operational and managerial issue too. Following, Hymer (1972) and Kindleberger (1983) both argue the importance of firm's ownership advantages, which is the key factor for MNEs to compete in foreign markets. Hymer considers that firms chose to direct invested in foreign markets as the importance to protect and transfer the ownership advantages and the need to strategic control and coordinate its overseas operations.

Dunning (1993a) argues that Hymer focused too much on monopolistic advantages, and ignored the role of MNEs in innovation and increased efficiency. He acknowledges the usefulness of the concept of ownership advantages, but says that Hymer did not adequately consider why and how these advantages might be transferred. He believes that more attention should be paid to the internalization and control of foreign value-added activities, and to the strategic and managerial issues confronting firms.

2.42 Transaction costs and internalization theory

Hymer (1960) emphasizes a firm's monopoly advantages to operate abroad to gain oligopoly profits over local competitors, when facing uncertainties and imperfections in the home market. Buckley & Casson (1976) argue that Hymer ignores the importance of the internal activities of firms. Buckley & Casson (1976), base on a previous theory, integrate important ideas of internal coordination and transaction costs, and develop the internalization theory,

which further considers how firms could enhance competitive advantages through managerial hierarchies to improve performance. Buckely & Casson (1988) also suggest that MNEs could reduce costs through strategy alliance of acquisition, merger or joint ventures. Internalization theory considers how a firm operates in a foreign market in order to minimize costs and reduce market uncertainties. Buckley & Casson (2002) argue that the reduction of transaction costs explains the motivation of cross-border operations. Internalization theory emphasizes the existence of managerial hierarchy from parent company to overseas subsidiaries. However, it ignores the influence from overseas subsidiaries and local agency to the parent company during the internalization process.

2.43 The Eclectic or OLI Paradigm

Hymer considered that the firm's monopolistic advantages were the key factors generating FDI activity. Buckley and Casson argue that market imperfection and transaction costs were key factors to explain FDI activity. Dunning (1980) states that neither view explains why a firm would choose to invest in one country rather than another. Dunning argued that the choice of location might have special factors to attract FDI. Dunning (1988) identify company's specific ownership advantages (O), location advantages (L) and internationalization advantages (I) as the determine factors for the expansion of international activities. Dunning (1980) developed those three factors as the 'OLI Paradigm'. Dunning (1993a) also argues that previous studies of international investment did not explain why MNEs chose FDI over their original export strategy or licensing. Dunning, based on the OLI framework, explains that, when firms have ownership and internalization advantages, without locational advantages, firms might to choose follow exporting advantages; when firms had only ownership advantages, without internalizing

capability, firms might choose to license to another firm with locational advantages in a foreign market; when firms had ownership advantage, location advantage and internationalization advantages, firms might choose direct investment in a foreign market.

Dunning (1980) states that ownership (O) advantage refers to specific firm competitive advantages, which is not only limited to an tangible assert such as natural resources, but also includes intangible assets such as technology, information, marketing skills, management, and entrepreneurial skills. In 2008, Dunning updated his ideas about ownership advantages, and classified the ownership advantages to three types, which included ownership asset (Oa), ownership transaction (Ot), and ownership institutional assets (Oi). Firstly, a firm's tangible and intangible assets, such as property rights, product innovation, and capability in marketing, were considered as asset-specific advantages, termed as ownership asset (Oa). Secondly, Dunning (1988) considered that the firms' capability for exclusive or favoured access to inputs, such as labour, finance, natural resources, and information; or the capability of parent firms to form cooperative inter-firm relationships to reduce costs; or the ability to access product markets; or the capability of governing its subsidiaries were considered as the firm's ownership transaction advantage, termed as ownership transaction (Ot). Firms can achieve size or economies of scope in order to enjoy monopolistic power over product markets, and so obtain resources at marginal costs. Thirdly, Dunning argued that the firm's business activities were influenced by both external and internal factors. Formal and informal institutions could influence a firm's business activity. He considered that a firm's capability to enjoy the advantage of geographic differences, such as the government intervention or assistance; the capability to reduce or diversify risks caused by currency differences or fluctuations; the management of local political and cultural impacts, and consumer demands; the capability to

learn from and combine experience of local markets better to exploit the asset and transaction advantages were themselves also kinds of ownership advantages. Furthermore, Dunning argued that institutional ownership advantages could counterbalance competitive deficiencies in other assets. Dunning & Lundan (2008) says that the three types of O advantage dynamically influence each other.

Location (L) refers to why firms place a subsidiary in a specific geographic area in order to gain what he describes as a locational competitive advantage. These locational advantages include the resource advantages, such as easy access to energy, resource and materials. Location advantages could also refer to low cost or well-educated labour in host countries. Moreover, they refer to physical and political infrastructure, including convenient transportation, or supportive industry policies. Furthermore, the potential and growing market of a host country was considered a locational advantage (Dunning, 2001). Raff & Von der Ruhr (2007) argue that marketing-seeking MNEs tend to expand their business where there exists a large customer base and potential market. For example, in service industries, such as banking, and retailing, market size and potential tend significantly to influence FDI flow. Resource seeking MNEs tend to choose locations with lower prices or scare resources. Efficiency-seeking FDI tends towards locations where low cost operations are possible.

Much FDI research considers low labour cost in a host country to be one important factor, attracting FDI in traditional manufacturing industry, particularly in an efficiency-seeking labour-intensive industry (Pan, 2003), in order to provide the low cost competitive advantages. Skilled labour in a host country plays an important role in attracting FDI, particularly in high technology industry. Marketing, manufacturing, R&D, finance and administrative activities

require capable people. The availability of skilled labour allows MNEs to strengthen the ownership advantage they possess. Market size and growth potential were important factors for both manufacturing and services FDI inflows, especially in strategies of marketing seeking. Hymer (1960) mentions that MNEs, which in his view operate in an oligopolistic market structure, where competition is intense, set up production and service operations in lower-cost locations that might provide the firm with the advantage it needs.

The degree of international openness could influence the calculations on location advantage. The lower the degree of restrictions imposed by the host location on international trade, then the lower the cost of doing business is, a consideration critical to financial services (Moshirian, 1997). It follows that what are called institutional factors such as tax rates, depreciation schedules, tariff rates, capital controls, exchange rates, and government regulation could affect FDI inflows. For instance, in China, after WTO, the financial sector attracted many foreign direct investors in financial sectors, as restrictions lifted, and made the sector a possible avenue for investment.

Dunning, inspired by Buckley & Casson' s (1976) internalization theory, argues that firms through hierarchies control foreign operations, and coordinate, manage and leverage their ownership advantages in foreign markets in order reduce transaction costs, which are considered as internalization advantages. More specifically, an MNE's internalization capability could help firms minimize costs, such as negotiating, search, moral hazard, adverse selection, and broken contract costs; protect the reputation of internalizing firms and limit ensuing litigation; capture the economies of interdependent activities; cope with low market demand; deal with government interventions, such as quotas, tariffs, price controls, and tax differences; control suppliers and conditions of

sale of inputs, plus market outlets; and engage in practices, such as cross-subsidization, predatory pricing, and transfer pricing as a competitive (or anti-competitive) strategy (Dunning, 2001).

The Dunning's OLI theory largely contributed to the international business studies. The OLI paradigm provides a theoretical framework to explain the motivation of MNEs to choose specifically location to expand its business. The main idea of Dunning's model is that firm will engage in international production because it has specific ownership advantages, it can exploit in a specific location, and can internalize these ownership and locational advantages to increase profits or achieve strategic. Ownership advantages can be effectively transferred, exploited and protected by a managerial hierarchy and corporate control through a process of internalization. Also, locational advantages can help the firm to enhance its ownership advantages. Dunning realizes the importance of location advantages, However, Dunning overemphasizes how a parent MNE might influence its overseas subsidiaries, based on the headquarter-centred rationale of internalization, and ignores how overseas subsidiaries could begin to influence the parent firm or other subsidiaries.

2.44 Criticisms of FDI theory

Hymer asserts that FDI involves the transfer of managerial and other resources, not just finance capital. Hymer considers that FDI occurs as MNEs choose markets in which they own competitive advantages, for instance using technological or managerial knowledge not available to other firms operating in a given country. Hymer believes that firms with ownership advantages become multinationals by seeking to gain further monopoly positions overseas through

FDI, and that these ownership advantages overcome the difficulties of being a foreign business in a host economy. He left unsaid the organizational means that made the transfer of ownership advantages across borders possible, and he does not demonstrate how multinationals can develop their advantage (building capabilities and organization) once the initial act of FDI has taken place. Hymer's theory does not identify why direct investment might be the preferred means of exploiting competitive advantages rather than exporting and licensing (Buckley, 1983, 1985, 1990; Buckley & Casson, 2002). Also, Hymer does not explain why MNEs chose to invest in a particular market or country rather than another. Furthermore, Hymer does not pay attention to how further ownership advantages might arise from the ability of firms to improve the allocation of resources or organize transactions, as experience, skilled management and 'learning by doing' begin to have impacts.

The internalization theory provides a well-explained model to analyse the internationalization of MNEs. Buckley & Casson (1988) argue that the reduction of transaction costs explains the motivation of cross-border operations. They later suggest that MNEs reduce costs through strategic alliance of acquisition, merger or joint ventures, and effectively synchronizing production or market capabilities. Multinational firms organize their internal structure to avoid excessive transactions costs (Buckley & Casson, 2002). However, as internalization theory stresses the influence of managerial hierarchy from the parent company on overseas subsidiaries, it ignores the influence of subsidiaries and local agency on the parent company or other subsidiaries, especially as firms seek to be more organizationally global rather than parent-subsidiary in their overriding structures and strategies. Furthermore, it ignores the difficulties a parent company faces managing and internalizing the overseas subsidiaries, which are mostly locational such as

government, culture, regulations, poor infrastructure, human resource short-falls, institutions, and distance.

Dunning's OLI paradigm provides the framework to explain the motivation of MNEs choosing a specific location to expand its business. Dunning (2001) mentions the emergence of transition economies, such as China, and that they require modifications to the internalization idea and to the eclectic paradigms. Originally, Dunning considered that FDI mainly occurs to exploit the O specific advantages of investing firms, and that resource and capability flow went only from parent to subsidiary. In these cases, the strategic motive is asset seeking, in which subsidiaries are acquired for their capabilities, and the flow in resources or capabilities is from subsidiary to parent (Dunning & Lundan, 2008).

Overall, firm specific advantages have been considered as an essential condition for MNEs. The idea of firm specific advantage in the process of internalization is expressed in other theories as 'monopolistic or oligopolistic advantage' (Hymer, 1976; Kindleberger, 1983; Vernon, 1979), and as the more economically positive ownership advantage (Dunning, 1977, 1980). The Hymer theory suggests that multinational firms' monopolistic advantage enable them operate in overseas market. Dunning (1977) suggests that ownership advantages were developed domestically by the MNE and then applied overseas, although he acknowledges the growing role of asset seeking in later years. Buckley and Casson's internalization theory suggests that the decision to invest and internationalize was not based on the extent of the cost of investing and operating overseas nor on ownership benefits of such investments and operations, but concerns the balance of total costs versus total benefits. This advantage might well be a non-monopolistic advantage –

that is, not a total advantage, but a net advantage - relative to other MNEs. However, FDI theories overemphasize the capability of the MNEs and its influence on overseas subsidiaries, and pay less attention on the impact of institutional, cultural and social contexts in home and host countries on a firm's development. They stress the initial motivation and condition for FDI, and on the whole do not discuss management after the act of FDI. Furthermore, they ignored the fact that strategies, structures and practices might change over time, and the reasons for those changes.

2.45 FDI theory and multinational banks in China

The nature of the service industry differs from traditional manufacturing industry. However, according to some theorists, the principle of the theory is still the same (Casson, 1990). Sabi (1988) argue that the existing theories of FDI were sufficient to explain the determinants of services FDI, as does Chen (2009). Previous theory considers that a firm invests in overseas market so as to exploit ownership advantages, reduce transaction costs, or look for resources or markets in a particular location. In service FDI, the motivations of service MNEs were also driven by various factors. For example, traditionally, FDI was taken by service industries because firms move abroad to support or complement trade or overseas manufacturing clients, as an emergent strategy for testing ownership advantage in and entry into a foreign market (Chen, 2009). After the initial stage, the motivation is similar to manufacturing FDI, which is to exploit ownership advantages in overseas market. Service MNEs ultimately also seek new clients, new markets or resources at a particular location, and exploit their own ownership advantages in foreign markets.

Dunning (1988) classifies the ownership advantages to three types, which included the ownership asset (Oa), ownership transcation (Ot) and ownership institutional assets. Dunning and Norman (1983) considers that the ownership advantages of service firms gain from their access to information and markets; economies of scale from spreading organizational and managerial costs over a larger market; and the extension of the goodwill that they posses from their brand names. Information and knowledge are intangible assets, which could provide service firms with their major competitive advantages (Dunning, 1988), such as, in banking industry, knowledge derived from experience in products, markets, clients, operational routines, and culture (Kogut & Singh, 1988; Jones, 1997; Gupta & Govindarajan, 2000). Those ownership advantages from service firms could also be classified within the OLI framework, as other industries.

Most services need to be produced when and where they are consumed. Service firms need localized services or person-to-person contact for exchanging highly confidential information or for adapting to rapidly changing customer needs. Traditionally, many services MNEs expanded their business overseas after following their client from the home country. Servicing home-based customers in host countries is an important factor for services FDI inflow. The existing client resource was considered as a local factor to attract the service MNEs to operate its service in a particular market rather than others (Li & Guisinger, 1992). For market seeking or resource seeking, service firms can choose to expand their business in an overseas market. For example, many multinational retailers such as IKEA and Wal-Mart chose to enter China for its growing consuming market. Those location advantages for a service firm could also be classified in the OLI framework, as other industries.

In service industries, organizational learning, quality of managerial resources, and internal coordination were important factors for MNEs expanding overseas. But regulations and legal requirements may raise transactions costs and limit international trade in services. An effective managerial structure or business strategy could help to reduce transactions costs in foreign markets. For instance, Cho (1986) suggests that multinational banks believes that the transfer of capital, management, and technological assets of a bank from one country to another can only succeed if those assets are integrated with local knowledge of markets, policies, regulations, consumer behaviour, and the same condition applies where multinational banks seek to create new competitive advantages in a local market. The process would constitute localization but would also, as classified in the OLI framework, require the internalization of mixed practices in the overseas markets, a pattern familiar to other industries.

Overall, existing FDI theories were sufficient to explain the international activities of service FDI. However, the existing FDI theories overlook the influence of overseas subsidiaries and local agency on the parent company during the internalization process, and ignore the difficulties faced by the parent company managing and internalizing overseas subsidiaries. They mainly focus on the flow of capabilities to overseas subsidiaries. However, in service industries, the need to adapt services to meet local markets and consumer behaviour will usually be greater than in manufacturing industry. Thus, there is a gap between existing FDI theories and service FDI, which are how multinational service firms respond and adjust their strategies and require the active involvement or local agency of subsidiary management to develop service products and networks in host country markets.

Cho (1986) considers that access to skilled personnel, managerial resources, favourable financial sources, efficient banking networks, knowledge and experience in multinational operations, expertise with a particular customer type, differentiation of banking products form the main ownership advantages in banking industry. Gray & Gray (1981), Casson (1990) and Cole (1998) state that the bank-client relationship and product development were particularly important as the main ownership advantages in multinational banking. Casson (1990) suggests that increasing FDI in manufacturing created demands for corporate banking overseas. Multinational companies prefer to use their long-term relationship banks with the same home country language and culture in order to reduce uncertainty, and the transaction costs generated by uncertainty (Engwall & Johanson, 1990). The nature of banking products suggests that it was the fear of losing existing banking relationships to a competitor bank that results in banks accompanying their clients abroad (Williams, 2002). The motive is not necessarily to earn profits in the new region but to prevent loss of an existing client (Kindleberger, 1983). Ellis (2000) argues that the bank-client relationship is one of the key elements in any bank's strategy. Cole (1998) contends that expanding banks must prioritize product development. Product adaptation and localization are important features of product innovation in multinational banking. A bank's innovative capability is related to its in-depth understanding of a local market and marketing abilities, as well as its product innovativeness. Multinational banks need to differentiate or innovate, by positioning products in a particular market or customer group. Also, Chinese local banks, coming from a state controlled and non-competitive market structure, are being forced to innovate and differentiate.

Location factors in multinational banking include differences in regulatory structures, the desire of investors to separate currency from political risk,

following existing clients, information collection, effective interest rate differences, different economic situations, skilled labour, and size of potential market. In China, the government and regulatory institutions and cultural factors were considered especially important elements, influencing the investment behaviour of foreign banks. The China Banking Regulatory Commission imposes strict regulations on the operation of multinational banks in China, and many foreign companies found the situation operationally difficult (Chen, 2009). Moreover, it is hard for foreign banks to expand their business amongst Chinese clients as they lack networks based on personal contact (guanxi).

Given the huge market size, multinational banks chose strategic alliances or joint venture as their entry mode, achieving quick access to local market resources and knowledge. Chinese banks are willing to cooperate with foreign banks to learn experienced managerial methods, advanced technology, and product development. China's institutions largely determine the entry mode of foreign investors, too. Casson (1979) argues that internalization factors were the availability and cost of fund transfer within multinational banks; efficient customer contacts; transfer pricing manipulation; improved networks for information gathering; and potentially reduced earning variability. For foreign banks operating in China, how to cooperate with a local Chinese partner became critical.

2.5 Chapter Summary

The rapid growth of the Chinese economy has been linked correctly to the success of the manufacturing sector and the export of industrial goods. The banking sector has similarly experienced reform since 1978, but, in its case,

change has been less complete, with the result that the Chinese government decided to appoint the CBRC to accelerate the development of capabilities and competitiveness amongst banking firms. During the period that followed, four of the five state owned banks have changed their ownership structure and have successfully been listed on the stock market. Large sized nationwide commercial banks such as CITIC have been restructured, as have medium to small sized regional banks. Capital and asset structures have been strengthened, although the quality of corporate information continues to be questioned.

However, compared to world leaders, major Chinese commercial banks are still weak in terms of asset quality, business profitability, and service diversification. There is a long agenda to build a well-functioning financial system: enhancing the corporate governance of commercial banks; founding a reliable credit culture; skilled and qualified personnel; product development; and technological innovation. The Chinese government realized that foreign strategic investment would speed the restructuring and modernizing of an ailing banking sector, by bringing equity capital, risk management techniques, new products and services, and international standards of governance. The foreign investors were attracted by China's rapid economic growth; the enormous market potential; and the opportunity to leverage a local bank's name recognition, customer base and distribution networks. The CBRC encouraged foreign banks to establish strategic alliances with Chinese banks. With respect to the Big Four firms, the Bank of America invested in CCB, and the Royal Bank of Scotland invested in BOC; and, in the same year, Goldman Sachs, Allianz and American Express signed a memo of understanding with ICBC, agreeing to acquire a stake. The CBRC acknowledged that investing multinationals brought improvements in corporate governance, cost control, operation technologies, and growth sustainability. By 2006, there were 14

authorized financial institutions, which established 191 branches, 61 branch offices and 242 representative offices, either wholly owned subsidiaries, or joint ventures (Chen et al, 2009).

However, factors frustrated the expectations of both the Chinese banks and the multinationals: long-standing problems of corporate governance, disclosure standards, asset quality, internal control in domestic firms, and the consequent increased caution by the foreign investors and decreased business cooperation. As a result, looking at the prospects of inward investment by financial multinationals, we can ask to what extent foreign investors could serve as the catalyst for improving the performance of Chinese banks.

FDI theory tends to focus on the specific ownership advantages of MNEs, or on the locational advantages of nations, and less on how host economy contexts influence the firm's development over time. Policy restrictions and the local cultural and business environment result in many uncertainties, and affect the development of foreign banking in China. Yet the huge business opportunities in the Chinese market still attract many multinational banks. The success of investments is related to the extent their knowledge and resources can be transferred and client networks are forged. To aid these processes, multinational banks tend to form strategic alliance with local banks. Chinese local banks in turn try to enhance competitive advantages by learning from foreign banks. The practical difficulties encountered raise questions as to what extent foreign banks do or can transfer ownership advantages to a Chinese partner, and about how Chinese local banks effectively gain competitive advantages through their joint venture. Can we in fact discern the impact on

operations at provincial and branch level? Furthermore, how does strategy change over time?

This research examines theories and ideas relevant to explaining the development of the Chinese banking sector in the last ten years and the planned role of reformed banks (incidentally but crucially linked to the next stage of the country's development). It considers the changing nature and structure of Chinese banking regulation, the use of inward FDI by multinationals with best practice know-how, and the extent to which they have or are able to transform firm level capabilities. As well as the topic of Chinese banking not being deeply researched, the existing literature so far does not combine these different perspectives to explain developments in China's banks. This study will analyse the development of banks, in a transition economy such as China, where both government policy and regulation and FDI are being used to transform an underperforming but highly vital industry. The fieldwork therefore will be based on interviews with managers at the operational level in Hunan province for the banks chosen for study. It will investigate the extent and cause of change in product development for business and retail customers, customer service and relationships, marketing, and human resources and re-training. The evidence will provide the basis for assessing the importance of changes being introduced into Chinese banking, and the emergence of new local capabilities in response to policy initiatives and economic needs. The acquisition or development of capabilities can emerge from different sources, including global or overseas best practice. In asking how the Chinese banking industry can acquire and develop new capabilities, the thesis reviews first the possibility of imitating the path followed by much of the country's manufacturing: learning through inward FDI and joint ventures. It is, theoretically, possible to transfer capabilities from a multinational to an overseas subsidiary or partner in services as well as

manufacturing, and this is especially true of internal capabilities such as systems, managerial knowledge, or technology. Nonetheless, services are more reliant on building networks external to the firm and on developing their services in conjunction or in response to local customers, that is they are relatively more location specific and context driven. Service firms may need to prioritize the creation of intangible capabilities in skills or knowledge with which to create locationally specific and responsive products or services. Moreover, while the potential for cross-border alliances can be positive, banking in China remains subject to a high degree of government control and regulation. The evidence suggests that multinationals have established relations as investors with the headquarters of banks, but that institutional arrangements have limited the levels of investment and the impact of the multinational transfer of capabilities at the local or operational level. We need to compare, therefore, the influence of FDI and multinational capability transfer alongside the influence of the CBRC, and, as improvement occurs, whether firm level strategy and management and market and technological factors have an increasing role in the development of firms.

Chapter 3

Government, Institutions and Strategic Capabilities

Following quickly from the creation of the three policy banks, the 1995 Commercial Bank Law of China enabled every firm to compete in all sectors of the banking industry, prohibited local governments from intervening in the commercial decisions of banks, and allowed foreign multinational banks to enter China through the formation of joint ventures. While many banks did take the opportunity to diversify, local governments still interfered in banks from all sectors of the industry, and foreign multinationals remained uncertain about operating a business in China and a result proved to be reluctant investors. The decision to join the WTO, in 2002, was a turning-point: the Chinese government established an institution, the China Banking Regulatory Commission, to supervise the banking sector more effectively, to provide regulatory protection against foreign competition for the short-term, and over the longer term to enhance the capabilities of domestic firms so that they would be in a position to compete in a more market-orientated scenario.

From 2003, the CBRC encouraged the banks to form strategic alliances with foreign multinationals from which they could learn management know-how and advanced technologies. At first sight, the policy seemed to imitate the joint venture policies, which had underpinned the growth of the manufacturing sector, but in fact the restrictions on ownership and the influence on decision-making were more strictly controlled. Moreover, the investment and commitment of the foreign multinationals declined within a few years, but the influence of the CBRC as an agent of change within the industry grew.

As a late developing economy, the state has played a key role in China's modernization, by implementing five year industrial strategy plans, reforming state owned enterprises and employment contracts, and facilitating and overseeing inward investment by foreign multinationals. The concept of the developmental state is important in our understanding of China's economic transformation, and, in Asia, government has undertaken an essential role in the early stages of industrialization in matters of technology, infrastructure, skills, and finance. One key component of industry strategy is the control and regulation of banking and finance to ensure the flow of cheap capital to major industrial and infrastructure projects. The developmental state has to create a set of viable institutions that can help and not stall the process of economic transformation. In China, the big four state-owned banks were given responsibility for supporting different areas of national development, but it was becoming evident that they and the local banking system had systemic weaknesses, which had the potential to undermine the country's long term prospects.

Government is the most important institution in any nation, as well as being the overseer of a country's institutions. In addition to passing laws and setting regulations, it controls or shapes the destinies of finance, education, and the labour market, with the result that it has the power to influence the nature of management and business. Furthermore, in developing economies with weak market mechanisms, its influence is necessarily more direct and extensive. For a highly influential body of management theory, it is the national institutional factors that are the most fundamental influence on the organizational characteristics of firms and on the behaviour of entrepreneurs or managers. Ultimately, they explain why business practices differ between nation states. But empirical work is needed to show exactly how the interaction of institutions and firms can lead to improved performance. In institutional analysis, there is a

lack of case evidence on both institutions and firms, and nothing of note that directly shows the interaction of reforming institution and firm. While, as happened significantly in China, FDI can be used to transfer management know-how and technology to indigenous companies, there is a need to trace how institutions can facilitate the process and to show how firms can increase their capabilities. The aim of economic development, moreover, is to promote indigenous firms and skills, and not to remain reliant on foreign technology and management. What type of institutions and firms are required to achieve this ultimate goal?

In China's banking industry, regulations have determined the entry mode, the strategic choices of foreign banks, and the areas of business activities open to national or local banks. The CBRC has become the prime institutional instrument of the central government, prohibiting the interference of local governments, and seeking to replace the influence of other government agencies or state owned enterprises. It attempts furthermore to guide the relationship of banks with foreign investors, which were not allowed in 2003 to found subsidiaries. There exists a large and important management literature on national institutions, and the ways in which institutions can determine the nature of firms and their practices. In the next section, we will survey this body of literature, and ask to what extent its premises can explain the firm-level characteristics and the development of banks in China. One aim of this thesis is to explore directly the links between institutional ideas and the enhancement of firm-level capabilities, and this chapter will explore too the literature on strategic management, firm resources, and capabilities. We can examine how effective a top-down institutional process has been in innovating management practice and diversifying firm-level capabilities. In the last chapter, we considered the impact of FDI and transferred capabilities on economic transformation, and the extent to which this process could explain Chinese

banking. National institutionalist literature by its nature has found it difficult to accommodate international factors or the impact of powerful multinationals. This thesis will consider elements of the debates on institutions and FDI that have been comparatively overlooked, and it will consider to what extent institutional pressure, multinational investment, or firm-level strategy and agency can account for the evolution of Chinese banking in the period since 2003.

3.1 Institutions and Institutionalism

One of institutionalism's origins lies in long-term economic analysis that asks the fundamental question why some countries industrialized and developed and others did not. Those countries, which established systems of government and law that allowed entrepreneurs to capture the benefits of their activities and so avoided rent seeking flourished. In other words, they provided the conditions that allowed markets to function effectively. Davis & North (1971) consider an 'institutional framework' as 'the set of fundamental political, social, and legal ground rules that establishes the basis for production, exchange, and distribution'. North (1990) states that institutions are 'the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction.' He further explains that the institutional framework signals to organizations, which choices are acceptable and supportable, and institutional influences are mixture formal and informal constraints. DiMaggio & Powell (1983), however, reject the rational-actor model, and coined the phrase new institutionalism or neo-institutionalism to look at how firms must conform to the social norms. Scott (1995) follows this line of reasoning and considers institutions as "cognitive, normative, and regulative structures and activities that provide stability and meaning to social behaviour." Formal constraints include political rules, judicial decisions, laws, and economic contracts.

Informal constraints refer to socially sanctioned norms of behaviour, which are embedded in culture and ideology. It is because markets are imperfect that institutional norms are part of the realities of firm strategies and practices (Harriss, Hunter, & Lewis, 1995).

Meyer & Rowan (1977) and Zucker (1987) also take the view that a set of values and norms exist outside of firms and influences how the firm is managed and structured. Many scholars consider that firms who adapt to institutional pressures tend to obtain more scarce resources and show a higher survival rate than those that do not (DiMaggio & Powell, 1983; Singh, House & Tucker, 1986). Furthermore, and especially in the context of emerging markets where institutional change can be more common and more pronounced, those firms that respond to such changes are more likely to survive. Greenwood & Hinings (1996) argue that developments in the institutional context require adjustments in 'value commitments' inside organizations leading to organizational change. When institutional change is too dramatic or sudden, it is difficult to acquire the needed new value commitments and to find the right new organizing template. A key core competence for a firm, therefore, is an ability to adjust to transformations in external conditions, and to assimilate new external information based on experience of the previous context.

Neo-institutionalism focused on the formal and informal nature of national institutions and how they shaped firms. Organizational practices evolve over time through the actions and interests of those involved, and may become path dependent (Kogut & Zander, 1992; Kostova, 1999; Szulanski, 1996). But it is institutions that determine the nature of organizational practices and induce high levels of homogeneity (Meyer & Rowan, 1977; Zucker, 1987). DiMaggio &

Powell (1983) define three forces that account for institutional pressures, which are coercive, mimetic and normative forces. Coercive forces involve matters of law and obligation, while mimetic highlight the tendency of one organization to copy the successful practices of another. Normative forces deal with the desire to aspire to established social norms, and can refer to a kind of professional socialization and the acceptance of standard organizational models. It would follow that the subsidiaries of multinationals would be subject to national institutionalist pressures and in the long term adopt the practices of local firms. Similarities in practices across organizations would be expected as a result of isomorphic pressures (Eden, Dacin &Wan, 2001; Gooderham, Nordhaug & Ringdal, 1999). What the neo-institutionalist perspective overlooks, however, as we shall investigate later, is that home and host country factors determine the nature of multinational subsidiaries.

Whitley's national business systems approach differs in that it begins with an analysis of firms rather than institutions. He describes a national business system a 'relatively stable and cohesive configurations of firms and markets whose characteristics are, to a considerable extent, mutually interdependent and reinforcing. By definition, then, they do not change frequently or rapidly'. He then adds: Since national business systems 'become established in particular institutional contexts and are interdependent with dominant institutions, substantial changes in business systems are unlikely to take place in the absence of major institutional changes'. Although the analysis is not top-down, the main point is that firms are deeply embedded in their institutions, and the idea that institutions determine the structure of firms and the nature of management practices remains, as in the case of the neo-institutionalist idea (Whitely, 1999). As each nation and its institutions differ, they explain why each business system varies to an important degree (Whitley, 1992; Whitley, 1999; Whitley. 2000; Morgan & Whitely, 2003; Hill, 1995). The national

business system approach – sometimes called European Institutionalism – is associated with the societal effect approach (Sorge, 1991). Critics have noted how both institutionalism and the national business systems approach depend on an institutional determinism that ignores the human agency of entrepreneurs and managers and the influence of firms on institutions and markets. They allow little scope for firm level, industry or regional variations, and offer little explanation of how institutions themselves change over time (Smith, McSweeney & Fitzgerald, 2008). The variety of capitalism (VOC) approach incorporates the importance of human agency and firm-level action (Hall & Soskice, 2001), but nonetheless the flow of determinant influences is one way and top-down, that is from the national institutions downwards to business.

One further point of criticism is that, if institutions exert such strong isomorphic pressures, then from where do sources of innovation and changes emerge. Moreover, how can the emphasis on the power of national institutions accommodate the fact of international influences and global best practice? In particular, the subsidiaries of multinationals have the duality of cross-border integration and national responsiveness, and they must deal with the parent company control with its home nation influences and with host country institutions. In their later institutionalist writings, there was some attempt to accommodate these issues while retaining the central perspective.

For example, Whitley (2000) considers how home and host business systems will shape the transfer of business capabilities by a parent multinational to a subsidiary. He specifies four outcomes, depending on the relative strengths of host institutions and multinational practices, with some subsidiaries showing a

better fit with local or international practices, but where some adjustments are required. Whitley argues that the transfer outcomes could be influenced by the degree of institutional difference between home and host. When there is less difference between home and host institutional contexts, the organization forms and practices could transfer to the subsidiary wit minor alterations. When there are high institutional differences between home and host institutional contexts, however, the subsidiary firms tend to adopt local practice. While, therefore, Whitely allows for multinational influence on subsidiary practice, in the long term it is the national business system that will be determinant. Similarly, the societal effect approach sees that the host country's institutional context could eventually transform the transferred business model once characterized by the home institutional system (Sorge, 1991).

Morgan, Whitley & Kristenson (2001) and Morgan & Whitley (2003) present a range of transfer scenarios, depending on the strength of local institutions, or the ability of a multinational to achieve high degrees of cross-border integration. Strong institutions and low integration levels will see institutions as determinant, and weak institutions and high integration will bring the opposite result. Moreover, strong institutions and high integration levels will generate extensive examples of hybridity and variation. The degree of institutional difference between home and host economy explains the ease with which capability transfer occurs, and so large institutional differences imply greater transfer problems and more hybrid and innovation forms. Morgan (2003) proposes the concept of 'transnational space' which MNEs can create in their host country operations and within which they can develop innovative organizational forms. Institutions may still act nonetheless as constraints on the diffusion of international practices (Child & Tsai, 2005; Kogut, Walker & Anand, 2002).

While some authors have argued that institutional pressures in the host economy are the major factor determining subsidiary practices, others take the view that powerful multinationals and globalizing forces are increasing impactful (Beyer & Hassel, 2002; Morgan, 2003; Morin, 2000). Some authors have looked at subsidiaries rather than institutions or the parent multinational to explain the nature of management practices. While institutional and parent multinational influences can be strong, it is the agency and interests of subsidiary managers that explains the wide variety of management practice outcomes and numerous examples of hybridity. The power of subsidiaries is related to its capabilities and to its hold over valuable or scarce resources to which the multinational seeks access (Birkinshaw, 2000).

Rosenzweig and Singh (1991) accept that MNEs face both isomorphic pressure from the local institutional environment and cross-border pressure to achieve internal consistency within their organization. They state that the organizational structure and practices of subsidiaries could vary depending on the degree of pressure from local factor and the effort of the parent company to exercise control. Kostova (1999), Kostova & Zaheer (1999), and Kostova & Roth (2002) argue that Rosenzweig and Singh focus on transfer outcomes and ignore the transfer process, which will be affected by 'institutional distance' (the degree of difference between home and host institutions) and 'institutional duality' (the extent a subsidiary must comply with parent company practices as well as operating in the institutional context of the host country). Kostova & Roth (2002) refer to the 'institutional profile' of the host country (such as government policy, and legal requirements) and 'relational context' (the relationship between multinational and subsidiary), which will both affect the process of capability or practice transfer. Other relevant factors are the relationship between MNCs and their host environment as determined by notions of legitimacy and degrees of liability in being foreign (Kostova &

Zaheer, 1999; Lawrence, Hardy & Phillios, 2002; Zaheer & Mosakowski, 1997).

Rosenzweig & Singh (1991), Kostova (1999) and Kostova & Roth (2002) question the homogeneity of business practice implied by institutionalism in the long term, although they accept that context will cause adjustments to transferred business models. Westney (1993) argues that the transfer process can create innovation with firms. He defines four types of transfer process, which are 'elimination', 'internalization', 'functional equivalents' and 'organization creation'. Elimination refers to the host country factors forcing a rejection of the transferred model or altering others that are not wholly suitable. Functional equivalence refers to those parts of the original model that can be transferred because they can still operate in the host nation. Internalization refers to transferring elements of the original model appropriate to the host context, and simultaneously altering others. Organizational creation refers to the host country supporting the transfer of the multinational's model, which would require the powerful firm with needed capabilities that will help transform the local economy. Westney notes that the uncertainties of home and host factors or lack of knowledge can influence organizational practices and forms and bring about the hybridization of transfer outcomes. In other words, there are intended and unintended processes. He contends that firm could create innovations when facing pressures from local and home contexts to create the best practice. He considers too that parent company make the strategic choice to alter their original model in order to meet local requirements and as a consequence may achieve innovations. Institutionalism views institutions as determining organizational structure, management practices, strategic choices, the entry mode of MNEs, and the process of capability transfer to foreign owned subsidiaries. It tends towards the hybridization of transferred practices

based on both home and host country's institutional variations, cultural differences, market differences and the level of economic development.

Institutionalism sees business as ultimately homogenous within a single context, and underplays differences between regions, industries and firms. Its tendency to determinism leaves little room for agency, or for firm level strategy and differentiation. The transfer of capabilities by multinationals suggests at least the possibility of hybrid outcomes in managerial practice, as the original model accommodates host country institutions or subsidiary level agency. Peng & Heath (1996) and Peng (2000) consider that, since no firm can be immune from the institutional framework in which it is embedded, then an institution-based view of business strategy is necessary. Peng (2003) states additionally that the internal growth of firms can be institutionally constrained in emerging economies, and, as a result, firms depend on organizational and personal networks, as witnessed by the prevalence of *guanxi* in China. Peng (2002) defines 'institutions' as those factors related to the dimensions of national context such as culture, government, and social interactions', and both formal and informal institutional influence play important roles. In particular, he explores the relationship between institutions and multinational practice transfer, and how the process of practice transfer shapes the relationship between the headquarters and the subsidiary. He focuses on the firm, and analyses institutional forces as external factors in the evolution of practices and strategies. He allows for the notion of the large-scale transformation of national systems through institutional transition (Peng, 2000, 2002, 2003).

Oliver (1991) argues that institutions can facilitate strategy, and holds that firms with adaptive abilities can move beyond institutional constraints. Firms

can change their institutional environments by developing strategic responses instead of adapting passively. On the other hand, in transition economies, institutional patterns from the previous system may continue to shape firm practice, a form of institutional inertia (Peng, 2000; Newman, 2000; Whitley & Czaban, 1998). Management theorists pay attention to institutional frameworks because they have a large influence on corporate and managerial behaviour, and, potentially, on key strategic decisions or developments. It is interesting, therefore, that strategic management theorists have overlooked institutional influences on strategic choices, and not adapted their approaches to the circumstances of transition economies in particular. They have tended to consider the 'task environment', taking account of market conditions or technological drivers, but not institutional features. Child (1972) states that business strategy needs to 'recognize the exercise of choice by organizational decision makers'. Therefore, institutions have to be treated as independent variables. Strategic choice is the result of the dynamic interaction between institutions and organizations, as well as the industry conditions and firm specific resources that traditional strategy research has emphasized (Barney, 1991). Strategic calculations must look too at the formal and informal constraints of a particular institutional framework (Oliver, 1997; Scott, 1995).

More recent views of strategy – most obviously, the resource based view or RBV – asserts that firms develop internal capabilities and resources that can overcome environmental or external constraints, as well as the threat of competitors. A market-based institutional framework – as in the case of the US - can be contrasted to that of a government-led institutional framework prevailing in emerging or transition economies; where institutions or markets are underdeveloped or do not function fully, a personal relationship-based framework (guanxi in China) may also be relevant. Institutionalism has focused on the influence of institutions on organizations, and we can view these

influences as determining strategic choices. The determining nature of institutions on business organizations and strategies may be especially important in Asian contexts, and even more so in the case of China, where the central and provincial governments are deeply involved in the running of the economy, and where political contacts and personal networks are important to all entrepreneurs and key managers (Hollingsworth et al, 2000). Research on Asian economies has shown that institutions matter especially, and that more needs to be done to specify exactly how they matter, in which contexts, to what extent, and in what ways. Institutionalism involves the rejection of rational-actor or an efficiency-orientated model, but research into Asia in recent years has attempted to merge the two approaches, assimilating differing perspectives of North and Scott (DiMaggio & Powell, 1983). Although we can debate the mechanisms, the degree of influence, and the need to consider other factors, institutions must have an impact on the structure, practices and efficiency of businesses (Oliver, 1997; Scott, 1995). As we shall see in the instance of China's banking industry, institutional factors are strongly influencing the development of firm-level capabilities.

Child & Lu (1996) believe that institutional realities – as well as other factors – slowed state owned enterprise reorganization and economic reform in China. Most studies of institutional change on the internal operations of firms in China have concentrated on state owned enterprises (Lau, Qian & Roland, 2000). Such an interpretation runs counter to the developmental state model, in which the state as a set of institutions must act as a market substitute to initiate the process of investment, technological enhancement, industrialization and growth. In emerging economies, we can argue that institutions are comparatively strong in relation to organizations and firms, and that, as markets mature, then transaction costs and concepts in strategic management, most obviously the RBV, become more relevant. Jefferson & Rawski (1994)

aver that industry reform in China was the result of a market-led withdrawal of government controls, and increased property rights that provided the incentive for change. In reality, emerging economies often show elements of marketization and privatization mixed with strong institutions and regulations, and both have the potential to shape the business strategies of enterprises. Moreover, different institutions change at different rates, and so the effects can be complex. There is a tendency in analysing institutional influences to see institutions as static in relation to dynamically developing firms, but institutions constantly evolve, sometimes by design, and can have either a positive or negative impact on the strategic capabilities of firms.

How, therefore, can we explore the connection between institutions and strategic choices? Emerging economies and China in particular are sound testing grounds to explore the interaction of institutions and firm-level strategy. We can look at how multinationals act within host economies in the light of institutional change, and how local firms can build a sustainable competitive advantage in response to institutional initiatives. It is likely that to achieve the most favourable research results that longitudinal and case based approaches would be necessary. Furthermore, as we can expect the interactions between institutional change and firms to produce varied results, then there is an advantage in focusing on one institution but on several case firms. Hoskisson et al. (2000) note the role of the RBV in understanding emerging market contexts, in which existing managerial skills or technologies may not fulfil the transition to a market economy. The issue then is how do firms acquire such resources? In the meantime, domestic firms remain vulnerable to international competition or to FDI by multinationals. Yet joint ventures and strategic alliances may, they suggest, be the means of expanding firm-level capabilities (Hitt et al, 2000). The emphasis in the extant literature remains on institutions being a constraint and on global or overseas factors being a source of

economic change. The model portrayed has validity in many contexts, including industrialization since the open door policy from 1978 in China, but, as we have indicated, the interactions between institutions, firms, and multinationals in the banking sector are more complex. For the next step, we will discuss the concept of strategic capabilities, strategic capabilities in the service and banking sector, and the capabilities banks in China are seeking to develop. Subsequently, we can ask which factors are shaping the strategic development of China's banks, and to what extent these factors are multinational, institutional or management led.

3.2 Strategic Management

This section will discuss the early development of strategic management and its main theories and frameworks: briefly surveying the design school's SWOT analysis and the positioning school's five force's framework, the generic competitive strategies, before analysing the Resource Bases View and Dynamic Capability approaches at greater length.

3.21 The prescriptive schools

Mintzberg et al. (1998) describe how the prescription schools are more concerned with the formulation of strategies than the nature of the strategies themselves. The prescriptive schools are amongst the early writings on strategic management, and they introduce many strategic management terms, such as competitive advantages, competitive strategies, industry analysis, and the SWOT. The following paragraphs will discuss the design school and the positioning school.

3.22 The design school

The design school is considered as the foundation of strategic management theories as most of the key strategic management terms were introduced by this school during the 1970s, such as distinctive competence and competitive advantage. 'It provides the central notion that underlies the prescription in the field of strategic management, namely that strategy represents a fundamental fit between external opportunity and internal capability' (Mintzberg et al., 1998). One of the key concepts of the design school is the SWOT framework: strength, weaknesses, opportunities, and threats. Johnson et al., (2005) state that the SWOT analysis provides the key terms of the business environment and the strategic capability of an organization that are most likely to influence on strategy development. This framework is founded on matches between the internal environment, the firm's strength and weakness, and the external environment, its opportunities and threats.

Figure 3-1: Design School's Perspective on Strategic Formulation

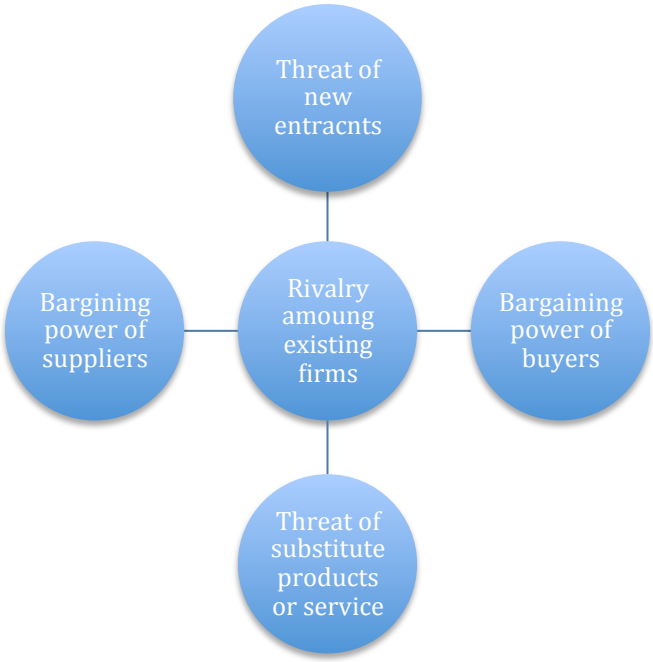
Source from: (Andrews, 1971)

The SWOT analysis provides a framework for firms to evaluate its strengths and weaknesses, as well as the external environment according to which it should implement and adjust its strategy. The SWOT made a great contribution to the theoretical development of strategic management by arguing that strategy represents a link between external factors and internal factors. However, there are two main disadvantages of the SWOT framework. One is that it does not help to identify the priority of any of the factors (Johnson et al., 2005). Grant (2002) states that it could be difficult in practice to distinguish between strengths and weaknesses and between opportunities and threats.

3.23 The positioning school

The positioning school developed the external framework to analyse how it is the basis of firm competitive advantages: it considers the attractiveness of an industry in which a firm competes and its relative position in that industry from which it can derive the greatest competitive advantage. Porter introduces two frameworks: the five forces framework and the generic competitive strategies. Porter's five forces include the bargaining power of buyers, the bargaining power of suppliers, the intensity of rivalry, the threats of new entrants and the threats of substitutes (Porter, 1980). Porter's five forces presents a tool for firms to analyse the external environment to help firms to face treats from within its industry.

Figure 3-2: Five Forces Framework



Source from: (Porter, 1980)

However, there are weaknesses in the five forces model. Firstly, it overemphasizes the influence from the external environment, and puts less emphasis on internal factors. Secondly, similarly to the SWOT analysis, it helps to present all the relevant external factors; however, it does not identify the importance of any factor in a particular case. It also does not point out how a firm can overcome its disadvantages, which in Porter's model are by their nature deeply embedded (Johnson et al., 2005). Thirdly, the Porter's five forces underplay other important external factors, which could influence an organization's development, such as the influence of government.

The premises of the positioning school focus on firm profitability, which are influenced by the growth, and profitability of industries, as well as by the strategic position of any firm within an industry. Porter (1985) states that a firm's relative position within its industry determines its profitability is above or below the industry average. There are three generic competitive strategies: cost leadership, differentiation and focus that a firm could follow to have better than average performance in its industry. Porter (1985) states that 'if a firm could achieve and sustain overall cost leadership, then it will be an above-average performer in its industry provided it can command prices at or near the industry average'. Porter (1985) argues that 'a firm that could achieve and sustain differentiation will be an above-average performer in its industry if its price premium exceeds the extra costs incurred in being unique.' The focus strategy asks the firm to choose either cost leadership or differentiation in a narrow segment of the market to pursue superior profits. One of the most important contributions of the positioning school could be its idea of strategic choice.

There are limitations in the generic competitive strategies. Firstly, Porter considers the cost leadership strategy to help firms to gain competitive advantages. Bowman (1991) argues that the generic competitive strategies do not give a clear boundary between 'low price' and 'cost leadership'. He further explains that competitive strategy should combine price and customers perceived use-value' rather than choosing lowest costs with average prices. Secondly, Porter argues that a firm could choose one of three strategic choices. Miller (1992) argues that he does not explore the possibility and necessity of moving from one strategic choice to another. Furthermore, Miller considers that ' strategic specialization may leave serious gaps or weakness in product offerings, ignore important customer needs, be easy for rivals to counter, and, in the long run, cause inflexibility and narrow an organization's

vision'. In practice, firms do adopt mixed strategies, and the combination of differentiation and cost leadership could be considered as a hybrid strategy. Thirdly, Schmaleness (1985) and Rumelt (1991) state that Porter overemphasized the importance of external factors and industries in determining firm performance. Opportunities and threats in external environments take precedence over the internal questions of resource and capability impacts. They both highlight the importance of firm-specific features influencing firm performance. Firm strategy needs to consider both external and internal elements.

3.3 Resource Based View

3.31 The development of RBV

Through the 1970s and 1980s, strategic management concentrated on how firms should respond to external factors, such as competition within an industry, consumer demand, or technological advances, and how firms adjust product development, operations, marketing and support services accordingly to achieve a sustained competitive advantage. Firms respond strategically to opportunities and threats outside the firm in an industry by identifying and utilizing the resources they control, and, as a result, it is the external environment that influences a firm's development. By the 1980s, researchers began to question the idea that firms developed resources and capabilities predominantly in response to external factors, especially since such a mechanism would not explain why a firm might produce resources and capabilities that are rare or unique when compared to a rival operating in the same environment. The Resource Based View seeks to provide an answer by concentrating on how firms evolve their internal capabilities, and, in a reversal of previous interpretations, on how the resulting competitive advantage has an

impact on the external environment. As we will see, if we look at trends in the Chinese banking sector, the strong institutional framework affects firms similarly, but the long-term objective is to create differentiated firms with their own competitive internal capabilities.

The RBV School can trace its origins to the seminal paper written by Coase (1937), which explained the rationale behind firm growth through transaction cost analysis, although the work of Penrose (1959) more obviously shows the historical antecedents. Penrose interprets the firm as a set of resources. She argues that expansion involves either exploiting existing resources or looking for new ones. It follows that a lack of resources - such as labour, machinery, or finance – will limit growth. For Penrose, the key resource for expansion is managerial capacity, just as the fundamental block on expansion is the lack of managerial capacity. Chandler, in his historical analysis of the emergence of large corporations in the US, and then in Britain and Germany, also emphasizes the key role of management in the growth of the firm and in the effective supervision of mass manufacturing and marketing (1962, 1977, and 1990). Williamson (1975) developed transaction cost analysis to understand the growth of large-scale firms, and considers resources to be physical capital (plant, equipment, raw materials), human capital (training, experience, skills), or organizational capital (formal reporting structure, coordinating systems).

Wernerfelt (1984) is the first person to use the phrase ‘resource based view’. He divides resources into the two categories of tangible assets, such as plant, technology, or capital, and intangible assets, such as brand name, in-house knowledge of technology, skills, or trade contacts. Wernerfelt mentions the concept of first mover advantages. In some cases, a firm can own a resource that gives it a positive position over those firms that do not own the resource at

a particular point in time. In these situations, a resource holder enjoys the protection and advantage of a resource position barrier. However, Wernerfelt does not illustrate how to exploit existing resources nor how to develop new ones. Furthermore, he does not show how to manage the firm's resources over time. He does not point out how to set up a structure or system, which can help a firm to execute its strategy.

Barney (1991)'s contribution to the RBV is to clarify how a firm can use its resources to attain and sustain a competitive advantage. He makes this link by formalizing the VRIN framework, which stands for value, rarity, imperfect mobility and non-substitutability. He has two fundamental assumptions: that a firm develops heterogeneous resources to differentiate itself from competitors and that these resources are imperfectly mobile between firms. Barney argues that a firm's resources can influence strategy as well as its development. To achieve this outcome, a firm resource must have four attributes: it must be valuable, in that it exploits opportunities and/or neutralizes threats within a firm's environment; it must be rare among a firm's current and potential competitors; it must be imperfectly imitable by other firms; and it cannot have strategically equivalent substitutes within other firms that are valuable unless they are also themselves rare or imperfectly imitable. Barney, therefore, develops ideas on the resource based view based by stating that firms within an industry (or group) may be heterogeneous with respect to the resources they control, and that these resources are imperfectly mobile across firms, with the result being that heterogeneity can be long lasting.

Grant (1991) states that resources – from capital equipment and skills to brands - are inputs into the production process, but he adds that productive activity requires the coordination of teams of resources. He argues that a

capability is the capacity for a team of resources to perform a productive activity. Grant offers a comprehensive categorization, differentiating between financial, physical, human, technological, reputational, and organizational resources. He notes in addition differences between tangible resources, such as equipment or finance, and intangible ones, such as skills or brands, with tangible resources being much easier to transfer, imitate or replicate than those that are intangible. His next step is to define the relationship between capability and resource: 'a capability is the capacity for a team of resources to perform some task or activity. While resources are the source of a firm's capability, capabilities are the main source of its competitive advantages'. The RBV explains how resources and capabilities are connected to a firm's competitive advantages. Not all resources can help firms to gain competitive advantages, implement valuable strategies, or improve effectiveness and efficiency, unless, as we have seen, they are inimitable and non-substitutable (Wernerfelt, 1984; Barney, 1986). Grant is additionally concerned with sustained competitive advantages, which is affected by the four factors of durability (not prone to obsolescence), transparency (extent to which a capability can be understood or imitated by a competitor), transferability (the ease with which a capability can be acquired by a competitor), and replicability (the fact that some capabilities cannot be easily copied in another context or by another firm). Grant, finally, notes that the RBV deals with the deployment of existing resources, and that there is a need in the long-term to generate new resources.

Fahy (2000) follows Barney and Grant in seeing the RBV as the need for management to identify, develop and deploy key resources in order to maximize returns, and in emphasizing the importance of what he terms sustained competitive advantage (SCA). Fahy, nonetheless, is wary of the confusion created by the different uses of terminology, and, to resolve this

problem, he distinguishes three distinct sets of resources - tangible assets, intangible assets, and capabilities. Tangible assets refer to the fixed and current assets of an organization which have a fixed long-run capacity, such as plant, equipment, land, stocks, and bank deposits, or capital good generally. It is relatively easy to measure the value of tangible assets, in which the ownership of the firm is apparent. In terms of generating long-term advantages, tangible assets are transparent or easily understood or imitated by rivals, and they are relatively weak at resisting duplication efforts. Intangible assets include intellectual property, such as brand, company reputation, trademarks, patents, company networks, and databases. It is difficult to measure the value of intangible assets tend to be difficult to measure. Many capabilities are interaction based, and, for that reason, they tend to be even more difficult to duplicate and measure. The inherent complexity and specificity of their accumulation hinder imitability and substitutability, at least in the short run. Capabilities involve teamwork, organizational culture, trust between management and workers, individual or group employee skills, and organizational routines, and it is through capabilities that the entire firm's resources are coordinated. Some individual skills may not be highly inimitable and non-substitutable, but complex organizational routines and interactions most certainly are. Resources become a potential competitive advantage when applied to an industry or a given market, but they do not confer a sustainable competitive advantage by themselves. Fahy emphasizes the emergence of management as a resource in identifying, developing and deploying the three types of resources appropriate within any particular market environment, and creating the SCA that generates a superior performance in market share, sales, returns, or profits. Theorists define a firm's given resources as leading to competitive advantages, and competitive advantages as stemming from resources. One way out of this difficulty is to look at how the firm creates new resources over the long term. Arguably, factors such as the complex interconnectedness of resources and causal ambiguities can explain

the inimitability of resource accumulation by a specific firm. However, it is possible that a firm develops out-dated technologies or its responses within industry sector in decline make it less flexible. In which cases, path dependent resource trajectories can turn into disadvantages.

There are various definitions of competitive advantage, but the concept essentially concerns the advantage a firm has over competitors in a given market or industry (Day & Wensley, 1988; Kay, 1993). Porter (1985) says, however, that a sustained competitive advantage (SCA) is one that is shown to last a long period of calendar time. Others regard see the idea of calendar time as demonstrating rather than explaining SCA, and concentrate on the danger of any competitive advantage being easily duplicated and consequently short-lived (Lippman & Rumelt ,1982). When a firm is said to have a SCA, it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors, and implies that other firms are unable to duplicate the benefits of this strategy (Barney, 1991; Barney, McWilliams & Turk, 1989). One firm's sustained competitive advantages limit both opportunities for current competitors and for potential competitors interested in entering the industry. When all efforts to duplicate an advantage have ceased, its sustainability is validated (Barney, 1991).

Clulow, Gerstman & Barry (2003) consider that Fahy's framework can be applied to financial service industry. Tangible assets could be buildings, which can be imitated, and personnel, which, since people can move between firms, is not imperfectly mobile, and their competitive advantage has the potential of being short lived. Intangible assets could be client trust, networks and reputation, which are difficult to imitate because they result from accumulated firm-specific activities, and accrue over time. Intangible assets may facilitate

the acquisition of tangible resources, for example, when personnel seek to join a firm with a high reputation. Capabilities could be team-embodied knowledge, organizational culture and history, which are also difficult to imitate. Clulow, Gerstman and Barry consider capabilities to result from team interaction and established organization routines, and, within financial services, therefore, it is not easy to replicate knowledge, experience, and judgment, even when personnel transfer to another firm.

The RBV emphasizes internal firm level capability as determining competitive advantage as opposed to aligning capabilities in response to the external environment. From the RBV, a firm's resources and capabilities determine business strategy and long-term competitive success. A firm evolves its strategy by developing and exploiting the internal resources and capabilities that allow it to be competitive. It could be argued that in manufacturing firm can make a product by utilizing its internal resources and capabilities without interacting directly with a customer. However, in delivering a service, a firm has to interact with a customer directly, and so it requires greater attention to developing resources and capabilities externally. For example, an automobile firm can train personnel in manufacturing processes in accordance to set routines, internal to the business, but a major part of human skills in services is concerned with client interaction and responding to more specific requirements. Networks, client relationships and reputation depend, amongst other things, on the very fact of interaction between personnel resources and clients.

In the Chinese banking sector, in which the market environment is highly regulated, the banks have little flexibility in deciding how to respond to external developments. Chinese banks seek to improve their internal resources such as experience, innovations, managerial ability and technological know-how in

order to secure and increase their position within this controlled if changing environment. Since tangible assets such as personnel are not perfectly immobile, they do not offer sustained competitive advantage, but intangible assets in client networks, trust and reputation do offer that possibility, being firm-specific, difficult to imitate precisely, and accrued over time. Capabilities in team-embodied knowledge, organizational culture and history are similarly hard to imitate. Lippman & Rumelt (1982) argue that physical technologies or tangible assets tend to be imitable, but human assets tend to be hard to imitate because of scarcity, specialization, and tacit knowledge.

In the retail-banking sector, there is relationship between interaction with clients and the building of internal capabilities. Discovering the cause of change in banking strategy and practice in China remains problematic, however. Chinese banks have also interacted with strategic FDI partners in order to enhance their capabilities, and they must respond to the policies of the China Banking Regulation Commission, which seeks to encourage higher levels of competitiveness. We can also see the government and the CBRC as an external and interacting institutional force for change on the internal capabilities of the banks, as might their efforts to build client networks and reputation.

Resources such as client relationship, networks, brand reputation, technology, product, information, employees' experiences are particularly important in the service industry. In later sections, we will need to detail these resources, and consider how their interaction with each other may be associated with hard to imitate capabilities and sustained competitive advantage. The framework provided by Fahy (2000) – the division of resources into tangible assets, intangible assets and capabilities – seems particularly suited to explaining

bank strategies. Because of the service or banking industry context, therefore, as well as the institutional context of the Chinese banking sector, some adjustment of the traditional RBV of strategy may be needed. As well as tracing the causes of strategic change, moreover, we need to look at how the banks have shifted from one level of capability to another over time, for which the Dynamic Capabilities Approach will have useful insights. In industries such as banking industry, it is difficult to define sustainable advantages, and competitive moves are rapidly imitated. For the purpose of discussion in this thesis, sustained advantage does not refer to a particular period of calendar time nor does it imply that advantages persist indefinitely (Gunther McGrath et al, 1995), but it depends on the possibility and extent of competitive duplication. How successful have Chinese banks been in developing inimitable capabilities and resources, and are we able to show that they can have a long-term effect on the evolution of this industry?

3.32 Limitations of RBV

Later work on the RBV attempts to deal with the links between a firm's resources, capabilities and competitive advantages, but questions remain about definitions and about showing specifically how the interaction of resources, capabilities and competitive advantages affects the strategic development of a firm. By turning attention to the internal dimensions of a firm, the RBV ignores the impact or influence of the external environment, and, while it does provide some indication of what is meant by sustained competitive advantage, the processes by which particular resources might provide competitive advantage over time are not clearly delineated (Priem & Butler, 2001). The RBV deals with the use of resources and capabilities at a point in time and with the generation of competitive advantage. Therefore, the RBV has not fully explained how and why certain firms have a competitive

advantage or can maintain a competitive advantage in situations of rapid and unpredictable change. In summary, there are concerns about the lack of empirically grounded research that proves which resources actually contribute to competitive advantage through the implementing of suitable strategies (Mosakowski & McKelvey, 1997; Williamson, 1999; Priem & Butler, 2001).

Prahalad & Hamel (1990) take a particular interest in the bundling of resources which most RBV scholars classify as yet one more capability amongst others. They do this because they regard the bundling of key resources as the constituent of what they term 'core competences'. Core competencies refer to the integration of skills, knowledge and technology that enable an organization to provide a particular benefit to customers. They further define core competence as the consequence of the 'collective learning of the organization, especially how to coordinate diverse production skills and integrate multiple streams of technology'. Others support them by depicting these core competencies as a major source of competitive advantage (Nelson & Winter, 1982; Reed & DeFillippi, 1990). Prahalad and Hamel's statement can alleviate a critique of the RBV - the lack of specificity - because the core competence perspective specifically focuses on the bundling of skills and technology as a core competence leading to competitive advantage. As with the RBV, rival firms must find such core competencies difficult to imitate (Reed & DeFillippi, 1990). The core competence concept, on the other hand, shares some of the problems detected in the RBV: the inattention to the influence from external factors and the process of organizational learning over time. Core competences cease to be competitive if changes in the external market are extensive and if a firm fails to learn and adapt overtime. The RBV only considers a firm's resources and competitive advantages at a point in time, and fails to consider the processes through which specific resources provide competitive advantage over a sustained period (Priem & Butler, 2001). The

idea of core competence suffers from one of the drawbacks of the RBV, namely lack of empirical demonstration.

Barney et al. (2001) discuss that the resource based view (RBV) could be applied to a wide range of management areas such as strategy planning, human resource management, marketing, organizational behaviour and international business. For example, the RBV might provide a theoretical explanation of a firm's diversification strategy, by pointing to the need for firms to develop new products and enter new markets where the resource requirements are matched by resource capabilities (Andersen & Kheam, 1998; Foss & Eriksen, 1995). Nonetheless, the precise mechanisms and illustrations of these processes in practice are not fully proven. The RBV has contributed most in the past years to the area of strategic human resource management (SHRM) (Wright, Dunford &Snell, 2001). As a result, people are seen as an important resource for a firm's development, and there is a convergence of strategy and HRM issues. The RBV would argue that specific human capital skills contribute to the competitive advantages of firms, and that individual employee behaviour could improve or detract from a firm's SCA. Wright et al. (2001) suggest that core competence or capabilities serve as a bridge between the emphasis in the strategy literature on who provides sources of competitive advantage and the focus in the HRM literature on the process of attracting, developing, motivating, and retaining people. So far, there is no empirical research to test whether HRM practice is path dependent, causally significant to a firm's development, able to impact the skills and behaviour of firms, difficult or easy to imitate, or closely linked to competitive performance.

In the area of marketing, Fahy (2000) suggests that, from the RBV, customer demand and opinions are important resources that could help to create

competitive advantages. For instance, customer demand is a resource that could help a firm to develop products. However, further work is required to identify how particular market-based assets and capabilities generate and sustain specific forms of customer value. So far, few researchers have touched the areas of corporate governance through the RBV. From one perspective - the issue of ownership - corporate governance is concerned with a dimension that is external to the firm, and as a result those interested in the RBV have tended to overlook this aspect. The other perspective focuses on the internal dimensions of firms, and RBV scholars have debated whether corporate governance could be a source of competitive advantage, and they have specifically considered the operation and effectiveness of boards (Short et al., 1999).

Peng (2001) argues that the RBV could support international theory that seeks to explain market entry strategies and other dimensions of a multinational corporation, including strategic alliances, international management structures, and emerging market strategies. For example, in analysing the motivations behind a strategic alliance, local firms might aim to acquire certain resources not available to their domestic rivals, while a multinational might tend to acquire certain resources to assist international diversification. Some scholars investigate the linkages between the RVB and the institutional environment. Oliver (1997) argues that the institutional environment could have an important impact for firm business strategies. Peng (2002) emphasizes the importance of institutional factors in emerging economies. He argues that none of the internationalization studies he reviewed directly measures organizational learning as an intangible resource. In empirically grounding the RBV, management information systems, ethics and corporate social responsibility, and organizational behaviour would all gain from further investigation.

3.4 Dynamic Capabilities

The RBV is concerned with the importance of specific resources in creating competitive advantages that contribute to a firm's development. It does not clearly explain how firms could achieve competitive advantages by implementing a fresh value-creating strategy, which cannot be easily duplicated by competing firms, because of the development of valuable, rare, inimitable, and non-substitutable resources. There is no general agreement on what constitutes the best single approach to the development of SCA. Therefore, Teece at al., (1997) suggest the idea of the dynamic capability approach (DCA).

The DCA refers to the abilities of a firm to achieve new competitive advantages, or, as Teece et al., (1997) state, the 'dynamic that refers to the capacity to renew competences to achieve congruence with the changing business environment'. They continue: 'innovative responses are required when time to market and timing are critical, the rate of technological change is rapid, and the nature of future competition and markets difficult to determine'. The DCA emphasizes the role of strategic management in selecting, adapting, integrating, and reconfiguring internal and external organizational skills, resources and functional competences in order to meet the needs of the changing environment. Dynamic capabilities are the firm's ability to integrate, build and reconfigure existing internal resources and external competences, and to create new competitive advantages for the firm within its industry. They underpin the ability to achieve new and innovative competitive advantages. Eisenhardt & Martin (2000) argue that dynamic capability becomes the source of sustained competitive advantage (SCA). They state that some dynamic capabilities deal with the integration of certain resources that can create competitive advantages, while other dynamic capabilities focus on the

reconfiguration of resources within firms to create new sources of competitive advantage, sometimes even requiring collaboration among various parts of the firm to achieve new and synergistic resources. Kogut & Zander (1992) bring in the concept of combinative capacities to describe organizational processes by which firms synthesize and acquire knowledge resources, and generate new applications from these resources.

The DCA shifts the emphasis to the configuration and reconfiguration of resources and competencies in order to achieve and sustain competitive advantage (Teece et al., 1997). Dynamic capabilities are specific strategic and organizational processes that create value for firms by manipulating resources into new value-creating strategies. They are a set of processes to identify and enhance a firm's best practices. The RBV focuses on existing resources and competencies (Grant, 1996), but the DCA is interested in generating and recombining new value-creating resources and competencies (Henderson & Cockburn, 1994; Teece et al., 1997). Grant (1991) defines capabilities as teams of resources being made to work together in the interests of a firm's strategic development, and, therefore, capabilities involve complex patterns of coordination between people and resources, as well as learning through repetition (Helfat & Raubitschek, 2000). For instance, managers could combine new technologies and knowledge of customer feedback to create a new product.

The DCA accepts that firms respond to external factors to create or combine internal resources to create completive advantages, which the RBV tends to ignore. The DCA, in certain respects, can incorporate Porter's positioning view. Firms must generally create dynamic capabilities, as opposed to buying them, in order to ensure their uniqueness. But, since firms overall aspire for 'best

practice', they may be commonalities across firms, and so dynamic capabilities tend to be more homogenous and substitutable than the capabilities described in the RBV. Eisenhardt & Martin state that 'since the functionality of dynamic capabilities can be duplicated across firms, their value for competitive advantage lies in the resource configurations that they create, not in the capabilities themselves'. Dynamic capabilities are necessary, but not sufficient, conditions for competitive advantage. Despite common features across firms, particular resource configurations ensure that no firm's dynamic capabilities are exactly alike another's. However, as with the RBV, it is difficult to identify and isolate what exactly is a dynamic capability or the dynamic processes that generate new value-added activities. The SCA similarly lacks empirical grounding (Williamson, 1999), and problems remain with figuring out which resource or competitive advantage has been created by which dynamic capability. While we might describe how dynamic capabilities build up 'best practice' within the firm, the extent to which other firms can duplicate remains unclear. The DCA does add the dimension of a firm's strategic development over time, but it does not give lucid guidance on the processes by which a firm moves from one stage of competitive advantage to an enhanced position.

3.5 Strategic Capabilities and Chinese Banks

Many scholars have investigated the RBV of strategic management, and looked at its implications for areas of management such as marketing or human resources. Bharadwaj et al. (1993) attempts to integrate ideas about SCA into the service industry, and does so notably in marketing and strategic management. However, there are few investigations demonstrating empirically how resources are formed or utilized. This gap in our knowledge applies particularly to services, and this sector's particular reliance on intangible assets and capabilities makes it harder to investigate or evaluate (Fahy, 2000).

As a result, we need to track the development of resources and their ability to produce competitive advantages over time (Fiol, 2001). Such an approach would additionally elucidate how external and market factors influence changes in a firm's resources and capabilities. There is no general agreement on what constitutes the best single approach to the development of SCA.

Dynamic capabilities are related to the gain and release of resources, which might involve alliance with and acquisition of other firms, in order to bring in new resources. Many Chinese banks have formed strategic alliances with foreign multinational investors with the aim of learning new resources and creating new competitive advantages. Dynamic capabilities involve the reconfiguration of resources, the acquisition of resources or their transfer, through internal processes or through the development of external relationships. Client relationships are themselves a vital resource for banking firms, but they also an external source of information and feedback, which can shape product development, itself a process of reconfiguring internal resources. Highly skilled employees are a key resource in the service sector, and their abilities are at the centre of creating new products and strengthening client relationships. Resources can be recombined to develop or utilize technologies that can provide new or better services to clients, resulting in the improvement of client relationships. Personal contact and interaction are important to the developing of networks and client relationship, and they have to be nurtured over a long time. Long term and value adding relationships with clients, which constitute a unique service that cannot easily be imitated or substituted by rivals, offers firms a sustainable competitive advantage. Moreover, as they are an intangible asset, and a complex set of combined resources, they are doubly difficult to replicate or substitute. If we look specifically at the Chinese banking industry, domestic firms have accepted

investments by foreign multinationals in the hope that such strategic alliances can enhance capabilities through learning.

Prahalad & Hamel (1990) refer to central, strategic capabilities as ‘core competences’, which are the collective learning in the organization, and they especially emphasize the coordination of diverse production skills and the integration of multiple streams of technology. Teece et al., (1997) state that the value of core competences is enhanced when combined with the appropriate resource. The degree to which a core competence is distinctive depends on how well endowed the firm is relative to its competitors, and on how difficult it is for competitors to replicate its competences. In the highly regulated Chinese banking sector, most firms provide similar services and products; therefore, in the long term, it has become important for Chinese banks to develop their own core competences to differentiate themselves from rivals and to possess a competitive advantage. Recent reform of regulatory institutions has had a significant external impact on the attempts to develop knowledge and capabilities.

In the service sector, intangible resources tend to be more important for a firm’s development than in the case of manufacturing. In banking, internal resources include managerial capabilities, knowledge of clients and market, product expertise, and financial strength. Moreover, external influences on these resources are indeed shaped by market changes, but institutional and government factors are notably important too. Banking is knowledge and human skills intensive. In the Chinese banking industry, there is a need to focus on the areas of human resources, client and customer relationships, product development, information technology, and the role of institutions, governance, and markets.

3.6 Chapter Summary

The major view in institutional analysis is that national institutions – government, finance, labour markets, or education systems – have the most important influence on the nature of business systems and management. Some authors have nonetheless addressed to what extent global or multinational factors can shape firms in the short or long term, given the level of institutional pressures that will exist. In the case of the banking industry in China, FDI has proved a channel for transferring the best or latest management practices and technologies, but, compared to the manufacturing sector, the impact has been less and other factors have been more evident as the driving force for change. Since 2003, the CBRC has enforced reform of the Chinese banking industry and its practices. On the other hand, its objective has not been to enforce traditional or embedded practices, but to use its supervisory powers to introduce international or foreign approaches that are representative of global best practice. Moreover, what the case of the CBRC and Chinese banking indicates is the importance of looking at institutional transformation, especially in a transition economy, and especially since the relevant theory pays little attention to the institutional evolution. We do not see a situation of contrasting stable Chinese institutions and rapidly developing international practices, but a context in which institutions, international influences, and domestic managerial practice are all fluid.

From the view of management strategy, approaches such as SWOT or Porter's five forces and generic competitive strategies are based on the idea that the external environment is determinant, and that firms make internal adjustments to achieve a fit with these exterior factors. In their perspective, the external environment is associated with markets and technologies, but not the institutional determinants evident in the relationship established between the

CBRC and Chinese banks. In other words, strategic management can usefully give a central place to institutional factors in explaining the emergence of capabilities that give a sustained advantage. As we shall see, when we look at the cases of Chinese banks, the CBRC has not only pushed improvements in practices and performances, under the same regulatory framework, but allowed firms to undertake strategies that provide differentiation from each other strategy. Institutionally determined change brought about the development of Chinese banks and the use of international ‘best practice’, as well as promoting more competition from local commercial banks and, still to a much more limited extent, multinationals. The aim is to enhance the capabilities of the Chinese banks and to prepare them for the international competition.

The resource-based view tends to focus on a firm's internal capabilities as determining business strategy. It argues that firms evolve capabilities and unique sustainable competitive advantages internally, and subsequently shape the marketplace. The importance of internal development is acknowledged, but so too is some measure of external influence, particularly, in Chinese banking, is we add institutional perspective. The DCA might be valuable in the analysis because it accepts the role of external factors. The DCA is less certain than the RBV about the uniqueness or inimitability of resources, but views managers or firms as creating unique combinations of internal resources which offer long term competitive advantage, and as doing so partially in response to external factors. The DCA, in certain respects, can incorporate Porter’s positioning view, but emphasizes responses to the market or technological environment and not the institutional. Firms must create dynamic capabilities in a way that ensures their uniqueness. But, since firms overall aspire for ‘best practice’, they may be commonalities across firms, and so dynamic capabilities tend to be more homogenous and substitutable than

the capabilities described in the RBV. Eisenhardt & Martin state that 'since the functionality of dynamic capabilities can be duplicated across firms, their value for competitive advantage lies in the resource configurations that they create, not in the capabilities themselves. Dynamic capabilities are necessary, but not sufficient, conditions for competitive advantage'. In the banking service, dynamic capabilities may refer creating and maintenance of customer relationships, product and service innovation, organizational learning often through training, and human resources. The business strategy may be a client driven strategy, a product driven strategy, or multi objective strategy. In terms of Chinese banking, with its strong regulatory institutional framework, Chinese banks are being challenged to develop dynamic capabilities to achieve higher degrees of differentiation and competitiveness. The extent to which they have been able to achieve such differentiation, notably within a strong institutional structure, is a major question for the thesis.

The RBV and DCA can be linked with the 'O' advantages of the OLI framework, by defining the nature of resources and capabilities to build ownership advantages. The RBV helps to explain the motivation of the Chinese government and Chinese banks, because of the need to improve the resources and capabilities of firms. It helps explain too the motivation behind allowing FDI and strategic alliances with overseas banks. An MNE with superior capabilities might through a strategic alliance with a local firm acquire local market based resources, and exploit and develop its competitive advantages in a host economy. The RBV in particular can include the idea that Chinese banks accepted foreign investment to learn about and to imitate the practices and capabilities that they lacked. The DCA is more focused on how firms transform existing resources and capabilities, or 'O' advantages, in response to market changes. The DCA supports the notion that capability might change over time.

Overall, under the control and guideline of the China Banking Regulation Commission, Chinese banks need to develop capabilities in management, skills, technology, products, and client relationships. The process has been top-down, with the CBRC working through the company headquarters. The main issue for the future is to what extent local agency and initiative will be able to replace the current high levels of regulatory control, and the implications of this desired transformation for the nature of firm level capabilities.

Chapter 4

Research Methodology

There is, as we have seen, a shortage of research on the Chinese banking industry, and no studies taking a detailed empirical investigation of individual banks. While there have been numerous studies looking at the impact of inward FDI on manufacturing businesses, the role of foreign multinationals in Chinese banks is comparatively under-explored. Mainstream FDI theory acknowledges the importance of political, market, and institutional factors alongside the role of the parent multinational, yet it has stimulated little case-based research demonstrating how these factors interact at the level of the subsidiary. Institutionalist theory emphasizes the effects of formative national institutions on firm-level management practice, but the literature offers limited insights into how such external factors directly shape the evolution of business strategies and internal organization. This thesis uses ideas from the resource based view (RBV) of the firm in order to define and describe the resources and core capabilities of Chinese banks, and compares the extent to which they have changed during a period of institutional and regulatory change and the instigation of inward FDI into the industry. It subsequently utilizes perspectives from the dynamic capabilities approach (DCA) in order to evaluate to what extent FDI, government policy and institutions, market, technological, and local management and agency determined the evolution of resources and core capabilities in the five case studies under investigation.

The research questions were generated through an analysis of the existing literature on Chinese business and specifically the service and banking sector, and through an understanding of influential theories on FDI and institutions. As noted, the case-study approach was adopted in order to provide responses to

the research questions. It was important, too, to examine the type of information and data needed to answer a set of research questions, and the practicability of conducting the research topic and securing the information and data needed. This chapter will explain the research design and chosen research methods, ethical considerations, and tests of validity and reliability for the empirical analysis and frameworks. It will mention in particular the use of pilot studies to frame and reframe the research questions, and how a shift in the theoretical framework became necessary.

This chapter includes six sections. The first section compares and contrasts quantitative and qualitative methods, and discusses why this research chose the latter. The second section explains the choice of the multiple case studies, and the third explains the criteria used for the selecting cases. The fourth section outlines the data collection process and the analysis. The fifth section explores the advantage and disadvantages of the research design, which is followed by the sixth section summarizing the chapter.

4.1 The Choice of Qualitative Methods

Polonsky & Waller (2005) define quantitative research as based on measurement and the use of mathematical, numeric, and statistical models to offer probabilistic estimates of findings. Quantitative methodology tends to gather a large amount of data, and use the results of statistical tests or multiple regressions to generate conclusions. An advantage of quantitative methods is producing numerical reliable results regarding the interrelationship between variables (Creswell, 2003). Flick (2006) argues that quantitative research does not provide data that facilitates deep understanding of events, cases, and the complex factors shaping these events or cases. Neuman (2000) argues that

quantitative research often separates the research objects from their context, which limits their capacity to discover or explore initially unknown variables. Wright, Beamish & Lane (1988) state that quantitative methodology has been criticized for its failure to understand social, cultural and political contexts. Saunders, Lewis & Thornhill (2009) define qualitative research as non-numerical and providing rich or in-depth resources for research. Creswell (2003) suggests that qualitative research methods provide more 'in-depth' information. Leavy (1994) believes that qualitative methodology focuses on change and process and on description and explanation; tends to gather data first-hand; and emphasizes the details of organizational life. These goals suit the study of Chinese banks, the development of their strategic capabilities since 2003, the extent to which they been successful in their aims, and the main cause of their transformation.

Overall, either of the main approaches combines advantages and drawbacks. Therefore, the choice of method depends on the nature of the study, the research objectives, and the research questions, as well as how the data required is to be presented. Yin (1994) argues that the qualitative research method is best adopted for answering 'how' and 'why' research questions. Parkhe (1993) states that the quantitative method suits answering research questions with 'who, what, where, how many or how much'. The quantitative approach for indicating the causal relationships between variables, but as less able to understand the interactions between inner forces and the outer context, which are hard to measure by quantitative methods, By contrast, qualitative methods allows researchers to experience the context, to improve their understanding of the phenomenon, and to achieve valuable insights.

The research in this thesis investigates the process of the development of management practice, linking a firm's past, present and future. In explaining Chinese banking reform, we are interested in management processes, communication, strategic decisions, their implementation, and their revision. This research concerns three main forces external to the firm and one force internal to the firm, and required in-depth understanding of banking organizations. It argues that quantitative methodology could not adequately investigate the variables and processes in Chinese bank reform, the varied result of human decision-making and interaction. Holdaway (2002) argues further that the qualitative method is suited to finding unexpected insights that emerge from the context of the research object.

This study chose a qualitative research design to investigate the impact of multinational investment, institutional regulations, and emerging firm level capabilities on the operations of China's banks, particularly in the areas of management and organization, human skills, client and customer relationships, product development, technology, and the development of retail and business services, which necessitated in depth opinions, thoughts and information, rather than numerical data. Qualitative research is more suitable for this research, as it allows access to the rich context of the research object, providing details for an in-depth analysis of the participants' opinions, and greater scope for conclusive findings and understanding (Easterby & Thorpe, 2002). It would be not be possible or productive to define, measure or manipulate the data under study, which would have been the basis of quantitative research.

4.2 Qualitative Multiple Case Study Approach

In social science research, Yin (2009) states that each method has its advantages and disadvantages, the choice depending on the type of research questions, on the control an investigator has over the events being researched, and on whether the focus is on contemporary as opposed to historical phenomena. Eisenhardt (1989) agrees that the case study strategy is particularly suited where researchers seek a deeper and richer understanding of the unit or event being studied. Yin (2003) takes the view that the case study strategy can be used for explanatory as well as descriptive research, because it can answer the questions 'why?', 'what?' and 'how'?. A case study strategy is considered as an effective way to define, explore, analyze, and challenge existing theories, and to build a new theory. This study investigates the development of China's banking industry. It looks at the role of government and the institutional regulation of banks, and at the impact of foreign multinationals on the organization and capabilities of firms. One of the objectives of this research is to answer the question 'why' the Chinese banking industry is undergoing rapid change in its management and business practices. Another is to answer the question 'how' those factors influence the development of Chinese banks, as well as 'what' strategies Chinese banks have used or could use to improve the competitive advantages. A qualitative case study method could evaluate the organizational setting whose complex influence could not be easily quantified. Therefore, case study is the appropriate methodology for research into the changing characteristics of Chinese banks.

One key component of case study is to define what the "case" is and how many cases are needed to substantiate the objectives (Yin, 2009). The unit of analysis is related to the initial research questions. A single case is normally

conducted where it represents a unique, or, alternatively, a critical or typical case, or if it offers a chance to observe, investigate and analyse a phenomenon that few have considered before. Multiple cases are normally conducted to find out whether findings could be generalized (Maylor & Blackmon, 2005). Multiple case studies have obvious advantages compared to singe case study. Evidence from multiple cases is often considered more compelling, and the overall study is therefore regarded as being more robust (Yin, 2003).

In investigating how and how successfully Chinese banks have attempted to develop their strategic capabilities, this research considers the main causes of the transformation, FDI and government regulatory institutions, and their influence on practices at the operational branches. Through multiple cases, and despite strong external determinants, we have discovered diversity in those practices and in the inter-relation between the factors involved. Multiple case studies provided data to compare and contrast how Chinese banks enhanced their strategic capabilities, and the variations and complexities in the dynamics of hybridization might have been neglected or downplayed. The banks are studied in their general and particular contexts, in which multiple forces from outside and inside the firm might influence the development of management practices over time. Multiples cases require extensive research resources and time compared to a single case study. Yin (2003) states that a multiple case investigation can address the research questions and issues emerging from the first case and guide the investigation of subsequent cases.

Replication logic can be used in multiple case studies. Upon uncovering a significant finding from a single case, a priority would be to generalize findings

by conducting a second, third, and further cases, in the hope of predicting similar results. Some replications might attempt to duplicate the exact conditions of one case, but other replications might alter factors in one or two cases if considered unimportant to the research objectives (Eisenhardt & Graebner, 2007). However, Hagg & Hedlund (1978) argue that the qualitative case study approach has limitations in establishing research objectivity, lacking generalizability, statistical reliability and validity, and only generating hypotheses but not testing them. Yin (1994) states that the validity and reliability of the case study approach could be constructed and enhanced by carefully designed research protocols and data analysis measures. Silverman (2000) believes that case study approach is not suitable for the generalizing of findings, but demonstrates particularity. Yin (2003) contends that using multiple sources of evidence such as semi-structured interviews, observation, and company documents and academic journals can enhance the validity of the qualitative multiple case study approach. He argues that the tactic of replication logic means that the case selection is made on theoretical rather than representative grounds to enhance analytic generalization. Analytic generalization could be achieved by carefully selecting cases based on the theoretical replication logic and comparing the empirical result of the case study with a previously developed theory. Yin (2003) states that finding the same results between cases and a theoretical replication could be claimed when the predicted difference is recognized across cases findings and achieves a literal replication. In the multiple cases study approach, every case needs to be selected base on the overall research objectives, and to achieve both literal and theoretical replications to strengthen the overall analytic generalization of the cases. This research chose five cases, comparing and contrasting their similarities and differences. Yin (2003) states that the similarities in the findings can achieve a literal replication and the differences can be used to create theoretical replications, strengthening the analytic generalization. Before all these replication procedures, the most important

step is to develop a rich theoretical framework. The framework needs to guide under which conditions a particular phenomenon tends to be found (a literal replication) and which conditions it is not likely to be found (a theoretical replication).

4.3 Selection of Cases

Eisenhardt (1989) states that the selection of sample cases in a quantitative approach follows random sampling and statistical analysis on the distribution of variables within the population, in contrast to the qualitative method, which identifies diverse cases in order to extend a theory. Pauwels & Matthyssens (2004) argue that the multiple case study does not achieve statistical significance and external validity, but develops theory through analytic generalization. Yin (1994) states that a theoretical sampling approach to selecting cases will enhance “replicative reliability”, and that replication can be achieved by obtaining similar results from all selected cases. To minimize the variation, case selection needs to be based on selection criteria. This thesis chose five cases based on the theoretical sampling approach based on the following selection criteria.

Firstly, it was decided to study banks to be found in the province of Hunan. As it was important to analyse the development of banks at an operational level, there were practical considerations in limiting the geographical scope of investigation. Access to banks and their management was furthermore paramount, and the researcher had built a network of contacts in Hunan. The market and local context would play a role in the transformation of banks, and there is wide variation in the nature and economic development levels of China’s many provinces, suggesting the value of conducting inter-firm

comparisons within one province. Hunan is not as developed as many of the coastal provinces, but has achieved measures of industrialization and urbanization to stimulate demand for banking services. Therefore, any case selected had to have operational branches in Hunan. Secondly, for reasons of comparison, it was decided to select different types of banks. In the Chinese banking system, the former directly and current indirectly state-owned national banks account for the vast majority of China's banking business. Alongside these are the newer and growing national commercial banks, established after the 1980s, and which have became the second largest players in the banking industry. Moreover, there is an expanding number of provincial commercial banks, serving local and regional markets, and growing organically and through mergers. As a result, the selected case firms had to cover state owned national banks, the national commercial banks, and the provincial banks. The mix of cases reflected the weight of the state owned national banks within the industry, but included examples of other categories. Investigations revealed that the state owned China Construction Bank, the Bank of China, the Industrial and Commercial Bank, the national commercial China CITIC Bank, and the provincial commercial Huarong Xiangjiang Bank would provide useful comparators and contrasts. Thirdly, banks were chosen once investigations revealed that each case would allow a suitable number of interviewees from different departments in order to gain coverage of various operations and to enable the cross-checking of opinions. Fourthly, all banks were placed under the regulatory authority of the CBRC, but, for comparison, it was decided to choose firms with multinational partners. The four national banks all received FDI, and as a group they allow investigation of the impact of cross border capability transfer and learning, with a view of tracking variations as well as similarities. Huarong Xiangjiang Bank was selected as one of Hunan's largest banks and a significant provincial bank in terms of the whole of China. It provides a contrast to the national banks, partly for only trading in Hunan, and partly as it has no multinational partner.

4.4 Data Collection and Analysis

The reliability of this research was enhanced by collecting data and information from multiple sources. This research mainly chose interviews in banks, but data was triangulated by the use of documentation, such as company internal documents, reports, websites, and academic journals in order to enhance internal validity in each individual case.

4.41 Semi-structured interviews

Yin (1994) states that 'interviews are an essential source of case study evidence, because most case studies are about human affairs. These human affairs should be reported and interpreted through the eyes of specific interviewees, and well-informed respondents can provide important insights into a situation'. Interview is one of the major data collection methods, and can be used by itself or as a component to a triangulation approach (Bryman & Bell, 2007). The major objective of interviews is to explore opinions, facts, and experience to result in an in-depth, specific understanding of a particular topic (Saunders, Lewis & Thornhill, 2009). This study aims to investigate the development of banking in China, based on investigation of existing relevant literature, evaluating the role of institutional regulations, the impact from FDI, and the emergence of firm level capabilities. The case based approach and interviewing enable in depth opinions, thoughts and information into the chosen research topic. For the chosen topic, the interview research method is suitable for collecting primary data. The interview could be categorized into three levels, which are structured interviews, semi-structured interviews and unstructured interviews (Saunders, Lewis & Thornhill, 2000). Structured interviews are based on a predetermined, well-identified and standardized set of questions. The interviewer is required to ask questions in the same order

and voice to avoid any bias infections (Singleton & Straits, 2005). However, it limits the interviewer in gaining deeper information from respondents. Unstructured interview is used when a researcher requires in-depth information and a free exchange of information, and there are no pre-determined questions. Semi-structured interviews are predicated on designing interview questions in advance, but they allow interviewees to explore other, new and potentially important issues to the research within the range of interview questions. They involve pre-determined questions in order to develop an understanding of a respondent's experience and perception of the topic, and to facilitate comparisons between interviewees, but not to restrict answers to confined questions (King, 2004). Questions and main themes are pre-designed and listed in order to offer a guide for the interviewer but tend to be open-ended to provide a greater scope of information from the respondents in the progress of an interview (Kvale, 1983). Semi-structured interviews offer flexibility to study, and the interviewer has some freedom to vary and also add or reduce questions according to the progress of the interview (Gates, & McDaine 2007). Wengraf (2001) suggests that managers prefer interviews rather than questionnaires or other methods, particularly when the study is relevant to their role and may help to improve their work and further development. The semi-structured method benefits from the fact that it allows the interviewer to develop a good relationship with interviewees, which might potentially result in a higher probability of responsiveness. The open-ended questions could encourage interviewees to say what they consider is important, so eliciting their views rather than what the interviewer thinks are important, generating the discovery of causal explanations, rival explanations, and unexpected issues during interviews, and enhancing the internal validity of the research (Chisnall, 1997). In this study, during one of the interviews, when the interviewee gave suggestions about removing the age restriction for promotion or recruiting staff, it generated for the interviewer ideas relevant to human resources policy, and led to call-backs to previous

interviewees to find their opinions about the age limitation. This study chose a semi-structured interview method to collect primary information.

4.42 Interviewee selection

The interview data, collected from a number of carefully selected respondents, are expected to provide diverse viewpoints, which offer the basis for constructing valid causal explanations (Eisenhardt & Graebener, 2007). The interviewees were carefully selected. Each case firm has multiple interviews: about 5 to 7 interviewees based on the same pre-designed interview questions for the triangulation purposes. Interviewees are those who were directly involved in the decision making process. Within each case firm, the interviewees were selected from different functional areas and hierarchical levels from the top management to the assistant manager level. There were other selection criteria: those who work in the field of human resources, customer relationships, information and technology development, and who were able to answer the questions related to the research topic; those who have a thorough knowledge of the firm and its rivals; those who worked in the case firm or in the bank industry before 2002 were more preferable, since they could review the whole period under investigation. In all the five cases, a wide range of employees was interviewed, including general managers, HR managers, department managers, chairs of the Labour Union, and those at province branch level and city branch level.

Table 4-1: Number of Interviews Per Case Study

Name of bank	Number of interviews
China Construction Bank	7
China CITIC Bank	6
Bank of China	5
Industrial and Commercial Bank of China	5
Huarong Xiangjiang Bank	5

4.43 Interview process

Fieldwork was conducted at the five banks in Hunan province, from 2012 to 2014. The researcher first went to Hunan province in the January of 2012, and started to establish relationships with certain employees within banks. In the November of 2012, the researcher conducted the pilot study, which focused on two banks, CCB and CITIC bank. The reasons for choosing these two banks for pilot study were the good personal connections in those organizations, and the chance to compare a 'big four' state owned bank and one of the largest commercial banks in China. After the pilot study, the researcher adjusted the research questions and the interview questions. Then, the researcher went to China to further confirm the names of interviewees in April 2013. The extended fieldwork was conducted in July 2013. In the January of 2014, the researcher returned to the banks to collect more internal documents. In some banks, the researcher was allowed to access to their internal online platform, which helped to gain a large range of internal documents.

The interview questions were designed to establish the interviewee's personal and career background, with a view to judging whether interviewees had the knowledge to answer interview questions in their specific areas, had an overview of the firm's development, and the reform of the industry. The interview questions were originally designed in English based, as a result of the literature review and subsequently a pilot study. The researcher is a native Mandarin Chinese speaker, who interpreted the interview questions into Chinese, and was able to have direct in-depth communication with Interviewees, reducing the chance of misunderstandings and enhancing the internal validity of the research. Yin (2003) states that it is important to safeguard interviewees who participate in any study, and this proviso includes protection of the privacy and confidentiality of interviewees. Therefore, at the beginning of each interview, all interviewees was assured that all the interview information provided would be used for the purpose of the PhD or academic research, and would not be seen or assessed by their firms. All interviews were conducted at the interviewee's office with no third party in attendance. The researcher began by introducing the research project and its purpose. Normally, the interview lasted about 1 hour to 1.5 hours, according to the original design and interview plan, and according to the interviewees' timetable and availability. Some interviews lasted up to two hours. The interview questions were pre-released to the interviewees. All the interviews were conducted on the basis of the pre-designed questions, and efforts were made to guide interviewees to provide requisite information and detail. But all the interviewees were allowed to comment freely on the relevant questions or to raise other points, and interviewees were not expected to respond to all questions if they felt they did not have the appropriate information or if they had concerns about confidentiality. Informal discussion proved an effective means of encouraging interviewees to give their opinions. After interviews, the researcher had lunch or dinner with the interviewees, which was an informal way to understand their comments and to integrate interviews further views.

Originally, the researcher planned to use digital recording, but banking sector remains a highly regulated and government controlled sector. All interviewees refused to be digitally recorded, and allowed the researcher to take written notes only during the interview. Hayes & Mattimoe (2004) state that the note taking method is as widely used as recording. The researcher used the pilot study to gain experience of note taking with the aim of not disturbing the process of interviews. All the transcripts were organized, reviewed and produced in Chinese, and then translated into English, within on day of each interview in order to achieve construct validity.

4.44 Documentation

Yin (2003) states that documentary information is likely to be relevant to every case, except for studies of preliterate societies. The most important use of documents is to corroborate evidence from other resources, and documents are important in the data collection plan. Firstly, documents are helpful to correct and verify spelling and titles of organizations. Secondly, documents could offer other detailed information to corroborate other resources. Thirdly, they can contain inferences as clues for further investigation, but overreliance on documents in case study research may cause the investigator mistakenly to assume that documents contain the unmitigated truth. However, the triangulation of documents with multiple sources is important to ensure the quality of the research. The period of fieldwork was between 2012 and 2014, and mainly during the summer in 2013. Lots of data and information from internal documentation was collected during the visits to banks. At some of the banks, the researcher was allowed to access their internal website in their office. Most of that information was confidential, and the researcher was not allowed to print. The researcher was only allowed to take notes, and limit use to the PhD and academic research. The data were used to triangulate and

supplement data from interviews. It is important to cross check and validate evidence from a multiple perspective, and analyse them from diverse angles. For this research, information was also collected from extant literature, reports and data published by research institutes and governments, and newspaper and journals articles. Through wide document collection, and corroboration with interviews, this research reduced biased selectivity.

4.45 Data analysis

Eisenhardt (1989) states that, for data analysis in a qualitative multiple case studies, 'the overall idea is to become familiar with each case as a stand-alone entity'. This process allows deep understanding of each case, and then generalizing of patterns across cases. This research analysed each individual case first, and then analysed across cases for comparison. Yin (1994) states that the data and information collected should be based on the analytical framework and theoretical propositions, defined from the preceding literature review. Pattern similarities could improve the reliability of the overall research findings, and pattern differences enhance the probability of capturing novel findings from the data collected. Yin (2003) states that the pattern matching logic comes from empirically based patterns found in case studies being compared with the patterns predicted in theory. Similarities in the pattern could enhance the internal validity of the research, and differences could have 'theoretical replication' across cases. The literal replication and theoretical replication could help to strength the analytic generalization of the research in the data analysis process. For example, the same result of three states owned banks adopting the targeted recruitment system, in which guanxi continued to play a role, shows literal replication. However, different results from the two commercial banks, which did not have the targeted recruitment system, reveal management and political traditions and an example of theoretical replication.

The pattern-matching logic is considered the most suitable general analytic strategy for analysing multiple case study research (Miles & Huberman, 1994). Yin (1994) states that it involves comparing an empirically based pattern with a predicted one. In the multiple case study, an individual case study is regarded as a stand-alone entity or a 'whole' study, and each case needs to be analysed separately. This allows unique findings from each individual case. Each case is then linked back to the research propositions, in order to test how and why a particular proposition was verified or not verified. Then the patterns found across case considered. A replication could be claimed if cases support the propositions, which means literal replication is achieved. The theoretical replication is achieved if this pattern is not observed in every case. Based on such matching, the propositions could be accepted or generalized to build a theory. However, if the cases produce contradictory results, the propositions should be rejected.

4.5 Validity and Reliability

A research design is supposed to present a logical set of statements, and we can judge the quality of any given design according to certain logical tests (Yin, 2009). Validity and reliability are both important factors for any research that involves information collection. Yin (2003) urges researchers to measure the quality of case study research designs by four criteria, which are construct validity, internal validity, external validity and reliability.

4.51 Construct validity

Case study research is criticized for lacking 'a sufficiently operational set of measures for the research questions addressed, which is difficult to construct validly' (Yin, 1994). Critics have articulated their concern on the use of data collected through the investigator's judgments while engaged in case study

research. Yin (2009) states that three tactics are available to increase construct validity when doing case studies. The first is the use of multiple sources of evidence. The second is the establishment of a chain of evidence, which is also relevant during data collection. The third is to have the draft case study report reviewed by key informants. The researcher should develop a sufficiently operational set of measures to avoid the invalidity of one single measure from a single source of evidence. Yin (2003) recommends that triangulation could avoid problems such as interviewees and documents being biased, and multiple sources of evidence essentially provide multiple measures of the same phenomenon. Triangulation refers to the use of different data collection techniques within one study to improve the richness and reliability of the information.

Firstly, interview transcripts were triangulated within a bank across the business functions. Management interview transcripts were triangulated with each other. Secondly, notes taken from interviews were reviewed immediately after the interviews. To construct validity, this study used the data collected from interview transcripts, observation notes, government documents, academic books, journals, newspapers, company published reports, internal company documents and websites, and triangulated them in order to enhance representativeness and meaningfulness. The process also reduces the possibility of misinterpretation (Ghauri, 2004).

Construct validity is increased by maintaining ‘a chain of evidence’ (Yin, 2003). Yin (2009) suggests that maintaining a chain of evidence could increase the reliability of the information in a case study. This is to allow an external observer to follow the derivation of any evidence from initial research questions to ultimate case study conclusions. This research established and sustained the link from the literature and research questions to the cases and conclusions, which enables a reader to trace the origins of the evidence and

conclusions. All the data and information used are cited in the bibliography, for the tracking of all data and sources.

Yin (2003) states that academic feedback could enhance validity. This research has been presented at Royal Holloway, University of London, School of Management conference every year. At these meetings, the literature review research, the pilot study, the methodology and fieldwork were all discussed, and received valuable feedback from academic scholars in my particular research area and in Management in general.

4.52 Internal validity

Yin (2003) states that internal validity is mainly concerned with explanatory case studies, when an investigator is trying to explain how and why event x led to event y. If the investigator incorrectly concludes that there is a causal relationship between x and y without knowing that some third factor z may actually have caused y, the research design has failed to deal with the threat to internal validity. In descriptive or exploratory studies, surveys or experiments, this is not an issue and there is no concern for the causal situation. For case study research, another point of discussion is the broader problem of making inferences, as a case study involves an inference every time an event could not be directly observed. The research design dealt with the overall problem of making inferences in order to enhance internal validity. Yin (2009) suggests that the analytic tactic of pattern matching is one way of addressing internal validity, which focuses on whether or not there is a good match between a researcher's observations and the theoretical ideas developed. Three other analytic tactics are explanation building, addressing rival explanations, and using logic models.

This research used a pattern matching logic, and established causal relationships across the case studies. This research used multiple case studies, and cross case comparison revealed similarities and differences in context, processes and outcomes. The researcher summarized the findings in the text and tables in the concluding chapter, and helped to minimize the risks of misapplying or mismatching the data. Yin (1994) states that, if the patterns of a particular causal relationship coincide across cases, it could be claimed that the correct inference of a causal relationship has been made. Then, those findings could be used for comparison with the research questions; the literature review and the analytic framework in order to further improve internal validity.

Since, in a case study, a researcher needs to infer an event in question was caused by a particular event that occurred earlier, based on the data collected, it has been argued that internal validity is hard to achieve (Yin, 1994). Pauwels and Matthyssens (2004) suggest that the use of triangulation could enhance internal validity, as it allows the various aspects of the research objectives to be based on multiple resources. Triangulation provides a more accurate comprehensive set of data on which an inference of causal relationship is based. Using the case study protocol could minimize errors and biases in the research to enhance the validity of the inferences. This research collected primary data through semi-structured interviews. The interviews provided basic information to establish a causal relationship, and the pattern-matching logic could enhance internal validity. Overall, this research selected cases based on selection criteria (theoretical sampling), and used triangulation and other methods to establish causal relationships and enhance internal validity.

4.53 External validity

External validity is the degree to which research findings could be achieved if the findings from one research can be generalized beyond the immediate case studies. Yin (2003) suggests that choosing multiple-case design to achieve 'replication logic' can be used for analytic generalization to enhance the external validly. This research was based on five cases, and the case selection was based on Yin's case selection criteria, which are theoretical replication and analytical generalization, with the aim to 'contribute to theory-building', and to be generalized in a wider context and to provide implications for further studies.

4.54 Reliability

Reliability is concerned with the data collected and findings during the research. If the research is to be repeated with the same findings, the study could be successfully referred as having reliability (Hussey and Hussey, 1997). In turn, reliability looks forward the consistency of results (Chisnall,1997). Yin (2003) states that 'The objective is to be sure that, if a later investigator followed the same procedures as described by an earlier investigator and conducted the same case study all over again; the later investigator should arrive at the same findings and conclusions'. The goal of reliability is to minimize the errors and biases in a study by clearly explicating the procedures of data collection. The most common way to ensure the reliability of research is to make as many steps as operationally repeatable as possible so that others could achieve the same results （Kirk & Miller, 1986） .

Yin (2003) suggests that the use of a case study protocol could reduce errors and biases during research, and guide the data collection procedures to

maintain consistency. The core of the case study protocol is the protocol questions as the reliability of the interview data is the key factor in the reliability of the search. The case study protocol provides a guide to the interview process and the maintenance of consistency. This research includes a basic protocol in the interviews to enhance the reliability as follows:

i. General company information: core business, company history

ii. Background of interviewees: age, education, career development, job responsibilities

iii. Detailed information across business functions: management & decision-making, HR, client and customer relationship, product development, information technology

iv. Contextual conditions in each company: past and present national/local context and relationships with local communities, governments and media at different levels

Furthermore, as discussed before, this research used a multiple case studies approach to achieve replicative reliability through comparing, contrasting and repetition to reduce bias and minimize the errors. The sample selection process was carefully designed to enhance the reliability and validity of the research. The method to store information collected is important in the construction of reliability and maintenance of accuracy. As stated, the researcher considers that digital recording is the suitable way to record the interview progress. However, the interviewees in this research tended to be unwilling to be tape-recorded during interviews. Also, it is difficult to record casual or informal conversations such as at lunch or dinner. Hayes and Mattinoe (2004) consider that note taking is an alternative to recording interviews. The pilot proved an important part of the process of fine-tuning the interview protocols. The interviewees were allowed to raise new issues within

the range of interview questions, which could help to strengthen the internal validity inference and enhance the reliability of the research.

4.55 Pilot case study

Yin (1994) considers that a pilot case study would help a researcher to refine the data collection plans with respect to both the content of the data and the procedures to be followed. The pilot study could assist a researcher to develop relevant lines of questions, and possibly provide some conceptual clarification for the research design. Methodologically, the work on pilot cases could offer information about relevant field questions and their effectiveness and clarity. Therefore, using a pilot study could develop the study's questions and test them. In general, convenience, access, and geographic proximity could be the main criteria for selecting a pilot case or cases. The pilot case enables you to observe different phenomena from many different views or to try different approaches on a trial basis. The pilot data offers considerable insight into the basic issues being studied. This information is used in parallel with an on-going review of relevant literature, so that the final research design is informed both by prevailing theories and by a fresh set of empirical observations. The dual sources of information help to ensure that the actual study reflected significant questions relevant to contemporary cases.

The researcher chose case studies in Hunan so that they all had the same con compare to context. Unlike the coastal areas, Hunan is an under developed inland province. Since the 11th Five-Year Plan, the Chinese government has aimed to accelerate economic development in the inland province. The Hunan government put the development of financial services as a priority position for economic development. This study chose the China Construction Bank (CCB) as one of the pilot cases, which is one of the four state owned commercial

banks in China; it has received FDI and is listed on the stock market. The China CITIC Bank is another pilot case, and was one of the earliest Chinese commercial banks. It has grown to be one of the most competitive banks, after four states owned bank. These two banks were chosen as pilot case studies because personal networks allowed space for more discretion and necessary follow ups in fine-tuning the interview protocols. The pilot studies used semi-structured interviews, and triangulated the results with written information and reports from firms and government.

Milliman & Glinow (1998) argued that the meaning or validity of translated questions might differ when research is conducted in different regions or countries. All interview questions were designed in English in the first place, as the content of questions was mainly based on a review of the literature mostly published in English. However, all the interviewees were native Mandarin speakers, with limited level of English. A translated Chinese version of the questions was necessary to conduct the semi-structured interviews. After the interviews, all collected information was translated into English for analysis, as this study is required to be published in English. The pilot study was conducted to ensure that Chinese version interview questions were accurate and understandable, and to minimize distortions and bias. The interviewer did not use academic terminology in order to make sure all interviewees understood the questions clearly.

All interviews were conducted face to face, which could enhance the validity of information. The first interview was with the vice manager of the China CITIC banks in Hunan province, which lasted about three hours. The interviewees tried to answer the questions as detailed and as clearly as possible. Many interviewees helped me to look up internal documents with which to triangulate my findings. For reasons already stated, note taking rather than digital recording occurred in the pilot interviews. After all the interviews, the author

analyzed the notes, and translated answers into English, with information categorized into key areas and in accordance with protocols in order to maintain meaning and assist comparisons between interviewees. Other data provided by the interviewees, such as company reports and government documents, and newspapers were used to triangulate the findings to enhance the validity and reliability of this study.

The interview questions for the pilot study were focused on the impact from FDI on ownership, strategy, product development, marketing, and customer service in Chinese banks. However, the foreign multinational banks had limited discernable impact on the development of banks at the operational or provincial level compared to other noted factors. Other interview questions were focused on the impact of central or local government on bank development. The China Banking Regulatory Commission appeared a good test for 'institutionalist' theory in seeing in detail how supervision can bring about firm level reform and to what extent international or FDI and other factors might be relevant. The CBRC shows a trend of moving from strong and direct government control towards a more decentralized approach to the banking industry, albeit with extensive central controls and policy objectives remaining. As more firm level decision making occurred, the need to focus on firm level developments and capabilities was re-emphasized. Therefore, the pilot studies helped redefine the research objectives. Moreover, the pilot interviews made the researcher realize that prompting techniques should be improved, and enabled the researcher to improve interview skills before undertaking the core fieldwork.

4.6 Chapter Summary

This chapter explains the rationale of choosing qualitative methods since they were the best means of delivering the research objectives and answering the research questions. Qualitative methods were suited to discovering in-depth information about the complex development of capabilities within Chinese banks at the operational level capability development, and analyzing institutional factors, FDI, and other contextual considerations as formative influences. The case selection was based on practical considerations, including access to data, but was based too on obtaining a significant number of interviews across different business functions, facilitating inter-firm comparisons and contrasts to maximize new insights, and isolating the contextual factors influencing firm development. This chapter explains the rationale of using a multiple case study strategy to answer the research questions of 'why' the Chinese banking industry is undergoing rapid change in its management and business practices; 'how' the development of Chinese banks has and is occurring; and 'what' strategies Chinese banks have used to improve their competitive advantages. This research chose the semi-structured interview and documentation as the main data collection methods. To enhance the reliability and validity of this research, it followed Yin's methods of construct validity and reliability, and internal and external validity. The chapter also explains the importance of the pilot study in order to refine the research objectives, the interview questions, and to enhance the quality of the research.

Chapter 5 The China Construction Bank

5.1 Background

The China Construction Bank Corporation (abbreviated as CCB) is one of the biggest former state owned banks founded on October 1, 1954 (see chapter 2), and its main task was supporting and allocating the funds to government construction and infrastructure projects under the centralized economy that existed at the time. It was not expected to operate on a commercial basis, but existed to service the needs of state owned enterprises. In the first phase of its reform, from 1978 onwards, the Chinese government launched its economic reform policy. CCB began to transform itself into a commercial bank, and, to be able to operate outside the construction industry; it expanded its business by providing loans, savings, deposits, and other services. It remained under the guidance and control of government, which determined which products it could offer. However, there were no obligations to compete. In the second phase of its reform, from 1985 until 1993, all four former states owned banks faced competition from new commercial banks. CCB entered into a third phase of its development, from 1994, when the policy banks were founded to take over major responsibilities for implementing government projects, and because the 1995 Central Bank Law incentivized the four state owned banks to more towards competition and profit concentrate goal (Jiang, et al., 2009). Concerned about the performance of banks and the slowness of their reform, the Chinese government established the China Bank Regulatory Commission (CBRC), in 2003, beginning of the critical fourth phase. The CBRC chose CCB and the Bank of China to be the pilots for its reform agenda to create more market-oriented and profit-conscious commercial banks. Along with the Bank of China, CCB was therefore the first to evolve from its state owned past, and

the lessons learnt were used subsequently to direct policy for other banks (CCB, 2013d).

5.2 Strategic Control

5.21 Ownership

Under the newly appointed CBRC, which aimed to create a commercially orientated industry, CCB restructured as a shareholding bank, named the China Construction Bank Corporation. Before listing on the stock market (December 2003), CCB disposed of RMB 185.8 billion of NPLs, with the MOF providing RMB 65.5 billion. Most of its non-performing loans were transferred to Cinda AMC (Hong Kong Stock Exchange Market, 2006). Therefore, by the end of 2006, 3.29 per cent of all its loans were NPLs, compared to above 20 per cent in 2002. The basic ownership pattern was established, and, as shown by the figures for 2007 and 2013, it remained intact for the five years. H shares are purchased through the Hong Kong Stock Exchange; A shares are purchased through the Shanghai Stock Exchange. The following list includes the top ten shareholders:

5-1 Table：Major Shareholders of CCB (2007)

Name of Shareholder	Nature of Shareholder	Total Number of shares held	Shareholding percentage
Central Huijin Investment Ltd	State-owned	138,150,047,904 (H-shares)	59.12%
Hong Kong Securities Clearing Company Nominee Limited	Foreign investor	28,209,724,301 (H-shares)	12.07%
Jianyin	State-owned	20,692,250,000	8.85%

		(H-shares)	
Bank of America Corporation	Foreign investor	19,132,974,346 (H-shares)	8.19%
Fullerton Financial	Foreign investor	13,207,316,750 (H-shares)	5.65%
Baosteel Group Corporation	State-owned	3,000,000,000 (H-shares)	1.3%
China Yangte Power Co. Limited	State-owned	1,200,000,000 (A-shares)	0.51%
Reca Investment Limited	Foreign investor	800,000,000 (H-shares)	0.34%
China Post Core Growth Stock Fund (a subsidiary of Agricultural Bank of China)	Domestic non-state owned	284,051,722 (H-shares)	0.12%
China Life Insurance Company Limited	Domestic non-state owned	233,696,00 (A-shares)	0.10%

(Source from, CCB annual report, 2007)

5-2 Table: Major Shareholders of CCB (2013)

Name of Shareholder	Nature of Shareholder	Total Number of shares held	Shareholding percentage
Central Huijin Investment Ltd	State-owned	142,590,494,651 (H-shares) 444,270, 519	57.03% 0.18%

		(A-shares)	
Hong Kong Securities Clearing Company Nominee Limited	Foreign investor	70,551,277,133 (H-shares)	28.22%
Temasek Holdings (Private) Limited	Foreign investor	17,878,670,050 (H-shares)	7.15%
State Grid Corporation of China	State-owned	2,895,782,730 (H-shares)	1.16%
Baosteel Group Corporation	State-owned	2,000,000,000 (H-shares) 318,860,498 (A-shares)	0.80% 0.13%
Bank of America Corporation	Foreign investor	2,000,000,000 (H-shares)	0.80%
China Ping An Life Insurance Company Limited	Domestic non-state owned	1,907,104,725 (H-shares)	0.76%
China Yangte Power Co. Limited	State-owned	1,015,613,000 (H-shares)	0.41%
Reca Investment Limited	Foreign investor	856,000,000 (H-shares)	0.34%
China Ping An Life Insurance Company Limited	Domestic non-state owned	593,906,825 (A-shares)	0.24%

(Source from CCB annual report, 2013)

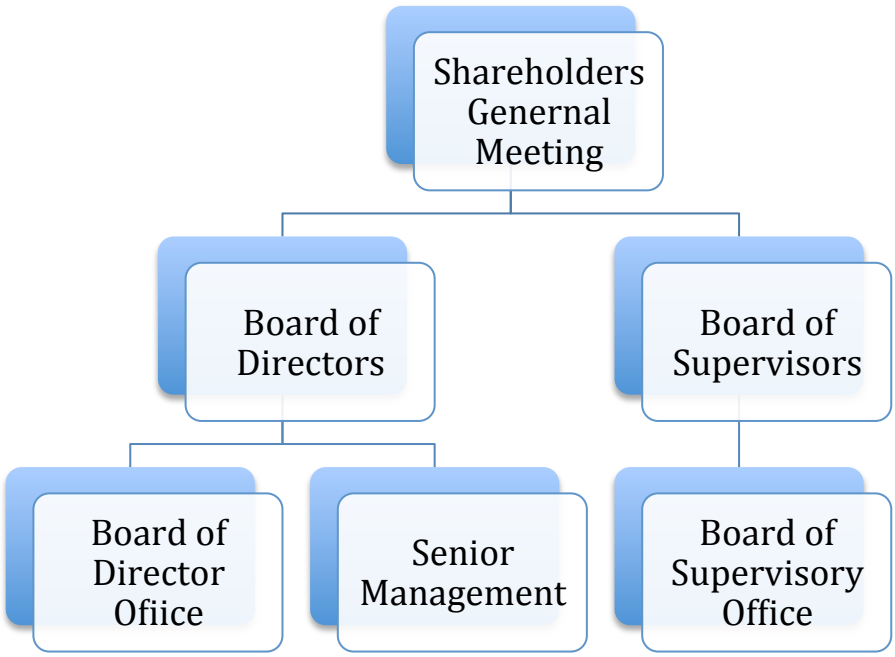
Both in 2007 and 2013, among the top 10 shareholders, there were four state owned enterprises and four foreign investors, as well as two private firms. The Central Huijin Investment Limited holds the largest ownership control of CCB. Despite the change in ownership structure, the Board of Directors at CCB maintained responsibility for management decision-making, albeit working within the policy framework set by CBRC and having to gain its approval for key actions. Chinese state owned companies with shares in CCB are not expected to exercise operational control. Multinational investment in CCB is comparatively small, and so foreign investors are unable to determine management decision-making. Shareholders are in practice limited to giving opinions at the shareholder's general meeting for reasons of broad supervision and corporate governance. One aim of the change in ownership and objectives has been to improve internal management, and notably the appointment of senior manager became based on performance and examinations, if subject to the CBRC's final approval. One representative of the Bank of America is allowed to attend the Board of Directors, but has no management responsibilities (see CCB's organization structure in Figure 5-1). In the head office, about 50 personnel from the Bank of America assist in risk management, governance, consumer banking and other areas, but again as advisors and without any management responsibilities. At the provincial level, such as in Hunan, there are no personnel from the Bank of America (Mr Li Lin, Sub Branch Vice Present, interview, 7th November 2012).

The management structure, as in Figure 5-1, shows that below the headquarters and its departments are the provincial branches (Tier 1), the autonomous regions of Hong Kong and Macau, municipalities such as Beijing and Shanghai, and special listed cities such as Shenzhen, the hierarchical organization following official government structures. There are in addition the overseas branches and representative offices. Each province, municipality or

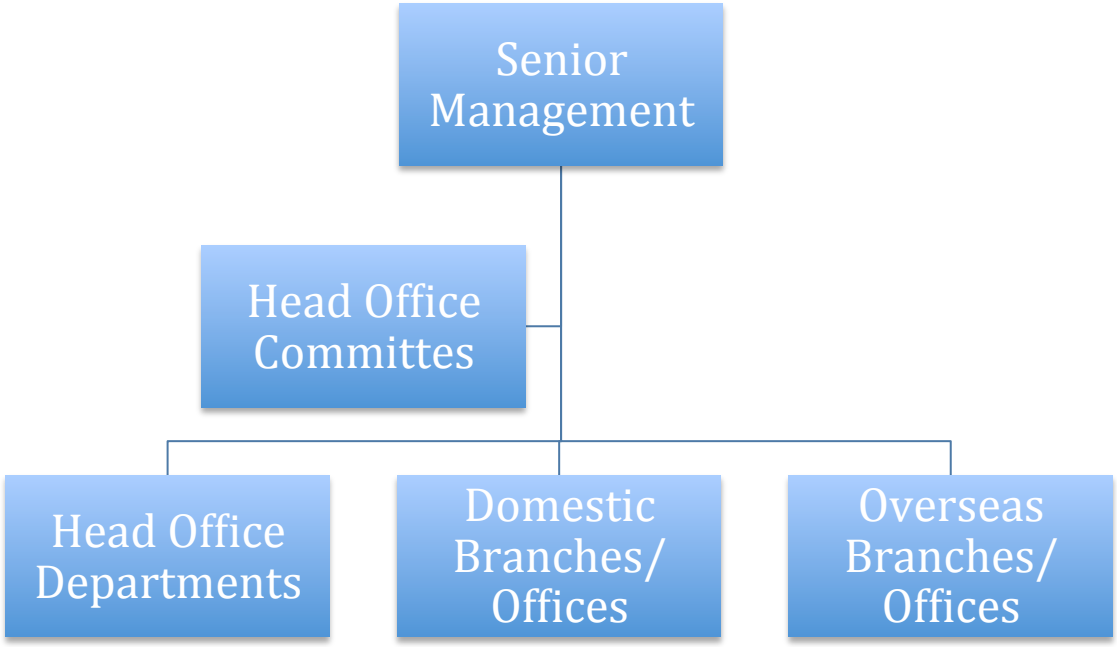
special listed city has its own headquarters, usually with departments in human resources, information technology, and credit cards. Within the province, the headquarters follows the policy and decisions of the company headquarters, and ensures implementation at the city (Tier 2) or country sub-branches, which deal directly with customers. The municipalities act similarly and oversee operations in urban district, just as special listed cities and autonomous regions have sub-branches. Decision-making within the provinces – as in the autonomous regions, municipalities and special listed cities – is limited. The provincial, municipal and listed city branches have specialized departments at their headquarters, in order to coordinate with the main office, and to manage corporate clients.

Figure 5-1 Organizational Structure of CCB

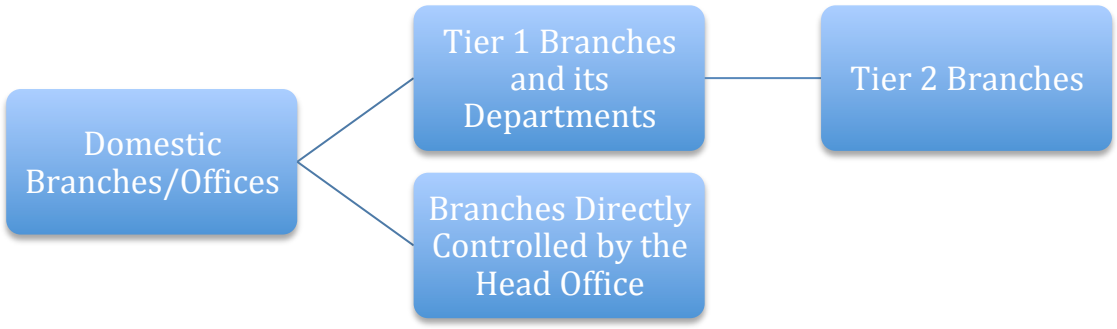
Shareholder's Level



Senior Management Level



Domestic Branches/Offices Level



As we have noted, after more than two decades of reform, the banking industry still showed signs of poor productivity, lack of risk management skills, and weak asset quality (Allen et al., 2005). In 2003, as we noted earlier the China Banking Regulatory Commission (CBRC) was found as an agency of the Chinese government to regulate and supervise the banking sector. The CBRC is charged with setting common standards for all banks, but the state owned banks believe that the standards set are more exacting for them than those for non-states owned commercial bank (Mr Shaoming Huang, Tier 2 Branch, Senior Client Relationship Manager, interview, 7th July 2013). The CCB Board of Supervisors monitors CCB, which is accountable to the shareholders' general meeting. The Board of Supervisors consists of 9 supervisors, including 4 shareholder representative supervisors, 3 staff representative supervisors and 2 external supervisors (CCB annual report, 2011). The banks need to operate and carry out business activities according to the Commercial Bank Law of the People's Republic of China, passed in 1995, and by the laws and regulations of the stock exchanges where it is listed.

In October 2005, at the stipulation of the CBRC, and with objective of further transforming into a commercial bank, CCB was listed on the Hong Kong Stock Exchange. The sales of just 10 per cent of the shares raised more than US $8 billion. In late 2007, CCB also floated on the Shanghai Stock Exchange. In the third period of the bank's evolution, as it began to compete and offer shares, it started its international expansion. In 2006, CCB set up a subsidiary in the special administrative region of Macao, and, then, from 2009, it created a foreign branch in New York and a representative office in London (CCB, annual report, 2009). By 2013, CCB had more than 13,629 branches in China, operations in Macao, Hong Kong, and Taipei, and ten overseas branches or

offices in New York, London, Tokyo, Sydney, Frankfurt, Seoul, Singapore, Ho Chi Minh City, and Moscow, and Johannesburg (CCB annual report, 2013).

5.22 FDI

FDI in China has largely been directed to the development of manufacturing and its management. In order to further enhance the competitive advantages of domestic banks, the CBRC encourages their cooperation with foreign banks. Chinese firms have formed international strategic alliances with the aim of creating new resources and competitive advantages. In 2005, the China Construction Bank Corporation (CCB) signed a five-year cooperative agreement with the Bank of America. CCB entered the joint venture in order to improve its managerial skills, human resource management, information technology, product development, and understanding of the implications of listing on the stock market. The Bank of America wanted to expand its business in China through CCB's network, seek new markets, and benefit from the strong growth of the country's economy (Cheng, 2011). The Bank of America is one of the world's largest financial institutions, covering both retail and investment banking services. The Bank of America deals with clients in 175 countries and has corporate business with most of the Global Fortune 500 and established offices in Shanghai, Guangzhou and Hong Kong. It acquired a 9 per cent stake in CCB worth US $3 billion (CCB annual report, 2005). The China Banking Regulatory Commission (CBRC) has strict regulations for foreign banks to operate in China. In September 2011, CCB revised and extended the cooperative agreement with the Bank of America to 2016. As the result, the multinational agreed to help with improving private wealth management, e-commerce, investment banking, information technology, product development, credit card services, and skills training. About 50 personnel from the Bank of America work in CCB's departments of risk

management, governance, and consumer banking. The Bank of America appoints one member to the board of directors, although that person has no management responsibility. Temasek, a sovereign wealth fund, from Singapore, is one of world's largest investment companies. It has invested in CCB since 2005. For the Chinese bank, it looked to learn from its investor's experience of stock market listing, reputation in international markets, knowledge of long-term investments, and training in treasury business and other specialist areas. However, as with Bank of America, Temasek has no management responsibility. In 2011, Temasek took 9.06 per cent of the shares in CCB, falling by some 2 per cent in the years that followed (CCB annual report, 2011).

5. 3 Human Resources

The reform of CCB started from 2003, as one of the two pilot initiatives of the CBRC, with the long-term aim of changing working practices and upgrading capabilities of the banking industry. This chapter will evaluate how much CCB has changed from the initiation of reform compared to 2013, tracking the evolution of capabilities and resources. Employee skills are a key capability in banking, and core to effective client relationships and product development. In the case of client relationships and networks, personal contact and interaction are important. To deliver a new product or service, the bank requires employees possessed of the training and experience to operationalize and manage expectations. Ultimately, companies need to generate products or services that are not easily replicated or substituted, as the foundation of sustained competitive advantage (SCA), and they require the personnel to achieve this objective (which we can associate with the notion of dynamic capabilities).

Reform began with the change in employment contracts in 2003. Under the new contracts, there are two types of employment: the direct contract system, in which employees sign a contract directly with CCB, and the outsourcing system, in which employees are hired through agencies. CBRC has guided CCB in the development of 'best practice' human resource systems, and CCB publicly states that they are seeking to combine Western models, especially the German variant, and Japanese approaches with selected aspects of the current Chinese system (CCB, 2013c). The RBV specifically argues that specific human capital skills contribute to the competitive advantages of firms, and that individual employee behaviour could improve or detract from SCA. As we have explored elsewhere, Wright et al. (2001) suggest that capabilities serve as a bridge between the emphasis in the strategy literature on who provides sources of competitive advantage and the focus in the HRM literature on the process of attracting, developing, motivating and retaining people.

5.31 Promotion

The reform process, from 2003, established human resource development as a major objective for CCB, with the aim of downsizing the number of employees, and creating the conditions to improve and change skills. CCB chose three main ways to achieve the new objectives. Firstly, all employees needed to pass an exam to retain their current position, or, depending on the results, they were selected for an alternative position, training or both. Secondly, for those long-serving employees hired during the 'life time employee' system, and above 40 years old, but who failed the exam, the company would allow them to retire early on a pension. Thirdly, CCB hired many capable employees from other commercial banks, although they would also lose people to rivals. Fourthly, the employment of less skilled positions such as cleaners, or particularly high skilled positions such as information

system developers would be sub-contracted. The measures introduced in 2003 were intended to change the nature of personnel and to create the space for human resource development in line with new strategic goals. At CCB, since 2003, key managerial staff were promoted internally rather than recruited from the local labour market. Internal selection has a rationale. Firstly, employees are more familiar with the business and prevailing 'guanxi' network. Secondly, despite reforms introduced at the outset of reform, the iron rice-bowl SOE system continues to affect promotion. Before 2003, promotion was almost entirely based on guanxi (Ms Yanmei Xia, Tier 2 Branch HR Manager, interview, 10th July 2013). From that date, no employee could be promoted without passing an examination, although guanxi still determined who would be promoted from amongst those who passed the examination.

CCB divides its employees into twelve levels. For example, the first level is the Chairman. The second level consists of the Vice Chairmen. On the third level are the department managers at the headquarters and the chairmen of provincial branches, while the fourth level is the department vice-managers at the headquarters and the vice chairmen of provincial branches. The fifth level is the department managers of provincial branches and the chairmen of city branches. Key managerial staff in or above the fifth level are directly selected and appointed by the headquarters, and need to be approved by the CBRC. Before their formal appointment, CCB evaluates all candidates for written examinations devised by CCB headquarters, and all candidates must pass (Ms Yanmei Xia, Tier 2 Branch HR Manager, interview, 10th July 2013). Normally, having achieved the necessary pass, it is those candidates with strong political, personal or organizational support within their department (and, potentially, from the higher levels of management) that are selected. Most of those chosen are members of the Communist Party of China, even CCB states that there is no connection between promotion and Party membership (Mr

Heng Chang, Tier 2 Branch, Chairman of the Labour Union, 10th July 2013). At the next stage, performance during the past years needs to be evaluated, and interviews are held at the headquarters. The Corporate Clients Manager, Hunan, Long Xu indicates that personal relationships with high-level officials are a vita factor of promotion after passing the exams (Mr Long Xu, Tier 2 Branch, Corporate Clients Manager, 11th July 2013). Appointments of key managerial staff below the fifth level are generally made within the province or city, although more senior posts remain under the decision of the company headquarters. CCB similarly evaluates the performance of candidates during recent past years. Some positions require a pass of examinations set by the provincial branch, after which there are interviews; in other cases, the bank just appoints directly. Occasionally, rather than internal candidates, the key managerial staff are recruited from the labour market, or appointed by the CBRC. Each position has different requirements in experience or qualifications, and there are additionally maximum age limits (Mr Long Xu, Tier 2 Branch, Corporate Clients Manager, interview, 11th July 2013; Ms Yanmei Xia, Tier 2 Branch HR Vice Manager, interview, 10th July 2013). The CBRC has a strong influence on the promotion of employees at or above the fifth level within provincial management. The whole of CCB's promotion system, therefore, is still largely a heritage from SOE practice, and 'guanxi' still plays an important role in an individual's progress. What has changed, however, is the introduction of examinations. While employees are likely to be promoted on the basis of personal networks, they must first prove that they have reached the basic requirements.

5.32 Recruitment

CCB undertakes – as we shall, in the same manner as the other state own banks - four types of recruitment: graduate recruitment, targeted recruitment,

open recruitment and internship. Graduate recruitment is the main method, and CCB prefers to hire full time graduates. Students must apply online one year ahead. The CBRC regulates that all candidates must graduate in the year they are hired. Also, students must study at a high ranking university, achieve good grades, and hold a level 6 in the national English test (4 level is the minimum level for university graduates) or an IELTS 6. For some positions in headquarters or branch level, applicants must have a Master's degree. CCB does not have requirements on students' previous work experience yet it prefers students who have participated in university activities or the student union. After applying online, then candidates attend written examinations, which are set by CCB headquarters, and these include English, administrative and professional skills, and knowledge and expertise. After the candidates have passed the examinations, CCB will select suitable appointees by interview. Recruitment policies favour well-educated young graduates with a high level of commitment to banking and CCB (Ms. Yanmei Xia, Tier 2 Branch HR Manager, interview, 10th July 2013).

Targeted recruitment is conducted as is graduate recruitment, but the openings are limited. It aims to hire graduates from a university or college, which in China has lower entry requirements and confers on the majority of its student's diplomas rather than Bachelor degrees. However, compared to graduate recruitment, CCB's grade or university ranking criteria are less strict. Otherwise, the online application, examinations and interview process are the same. Ms Yanmei Xia is the HR vice manager in Xiangtan City branch headquarters, and she indicates that this recruitment is more likely to open the door for graduates who did not reach the usual standard but have strong "guanxi" or they are the children of employees (Ms. Yanmei Xia, Tier 2 Branch HR Vice Manager, interview, 10th July 2013).

Open recruitment provides opportunities to local labour markets, with jobs advertised through the company website or recruitment agencies. Social recruitment is very limited, as CCB tends to promote their employees internally or to hire graduates. The bank uses this approach only when it cannot find suitable candidates from amongst its own employees (Ms Yanmei Xia, Tier 2 Branch HR Manager, interview, 10th July 2013). Every summer the China Construction Bank holds a summer internship programme for students who will graduate the following year. In instituting this practice, CCB is imitating Western style human resource practices (CCB, 2013a).

5.33 Training and Development

CCB realized the importance of training for employees in the banking sector. The previous SOE system ignored human skills as a resource to be developed. From 2003, CCB began to provide both on the job training and general training. For example, in 2011, CCB states that it organized a total of 29,166 training sessions, costing about RMB899 million (CCB annual report, 2011); by 2012, the figures had grown to 43,220 sessions at RMB1.18 billion. Employees at CCB need to self-study 10 modules on a course related to their positions, and to pass exams in the internal online platform (CCB annual report, 2012).

CCB organizes training programmes for different departments every year. When new products or new services are launched, the relevant department needs to conduct training, which is usually done in-house. External professionals provide English or Computer skills courses. The foreign partners of CCB, the Bank of America provides training courses in the area of wealth management. CCB frequently updates information and training materials, such as videos for employees to learn the latest product or service. The course

format includes telephone video conferencing, which provides the training for employees who could not attend the training in the headquarters in Beijing (Ms Yanmei Xia, Tier 2 Branch HR Vice Manager, interview, 10th July 2013; Qu, 2013). For new employees, they will undergo induction training to learn their job responsibilities and to understand the firm's corporate culture and values. Every year, CCB selects a department and some of its employees to visit its joint venture partner or to visit other banks overseas. For example, in 2007, the product development department selected employees to visit the Bank of America's product development centre (Li, 2013). The training programmes with foreign partners help CCB to develop products. The on the job training largely improves the specialized and general knowledge of employees. However, all training programmes emphasize specific knowledge or skills, and none deal with the concept of customer service.

5.34 Pay policy and welfare

CCB pay and welfare systems are partly an inheritance from its time as an SOE, and partly elements learnt from Western style HR systems. The pay structure is determined by seniority and the position-related system, plus a performance-related bonus. Both length of service and grade contribute to the basic salary and welfare benefits. The pay rate and welfare benefits are based on levels of local economic development. There is a formula to calculate the salary, which is based on basic salary plus the rate of local economic development. Performance related pay became an important incentive for improving job performance (Mr Li Lin, Sub Branch Vice Present, interview, 7th November 2012).

Employees had many benefits within the SOE system, such as a house purchase allowance, hospital allowances, childcare allowances, and child education scholarship funding. After the reform of the social benefits system, the social welfare such as hospital allowance, pension connects with social medical and pension system. CCB has not only participated in local social insurance schemes - covering basic pensions, basic healthcare, unemployment insurance, industrial injury insurance, and maternity benefits - but it has also set up a housing provident fund. For retirement and medical care, CCB has established two types of staff welfare systems: corporate annuity and supplementary medical insurance (CCB social responsibility report, 2012).

5.35 Summary

The current CCB human resource system is partly inherited from the Chinese SOEs system, and partly learnt from western style HR systems. The CBRC has direct involvement in the promotion and the appointment of senior managers but less direct influence on recruitment, payment, welfare, training and development. The SOE HR system lacked monetary incentives to improve performance. Also, the SOE iron rice-bowl and lifetime employment still strongly influence recruitment, as according to the HR regulations handbook, employees cannot be dismissed excepting for breaches of law. Staff turnover is not a problem for CCB because highly committed employees and local labour see the state owned banks as providing stable employment, good welfare, and high pay rates. In the SOE HR system, when employee's children grew up, they could work at the bank. After reform, recruitment tends to be open to all graduates and to local labour. However, CCB still has the targeted recruitment, which specially hires the employees' children or people with 'guanxi'. The idea of the internship was learnt from the western style human

resource practices. However, it has been argued that it does not offer fair opportunities, as there is still a large number of candidates attending the internship from 'guanxi'. The training programs largely enhance the general and specific knowledge of employees, but the concept of 'service' still needs to be further emphasized in their training.

The CBRC has little direct influence on recruitment. But all examination papers need its approval. Before the founding of the CBRC, recruitment at CCB was based on the procedures associated with state owned enterprise, and so the children of employees would be given positions. The new system of graduate recruitment based on examination provides a greater measure of fair opportunity for applicants. The examination-based promotion similarly provides more fair opportunity to all employees.

5.4 Client and Customer Relationships and Product Development

In the banking sector, a firm has to interact with a client or customer directly, so it requires attention to developing and maintaining relationships with its clients and customers. Long term and value adding relationships with clients, founded on a unique service that cannot easily be imitated or substituted by rivals, could constitute a sustainable competitive advantage. Client and customer relationships – and similarly product development - are key resources in the banking sector (Chen, 2009). Client and customer relationships and product development are closely tied together, as good client and customer relationships could help to develop unique products, and unique products could help to gain and keep clients and customers.

CCB generally divides their clients or customers into four categories, which are corporate client; small to medium firm client; individual VIP customer; and individual customer (CCB, 2013b). In 2011, CCB announced its 'customer-oriented' business principle. It made efforts to improve basic facilities such as ATMs. In 2011, the overall corporate client satisfaction rate was 90.5%, 2.2 percentage points up from the previous year (CCB annual report 2012). CCB refurbished its 7800 retail outlets, and established 940 individual customer service centres, 240 small enterprise service centres and 245 private banking customer service centres within selected branches. For relationships with corporate clients, small to medium firms, and VIP customers, 'guanxi' remains vital (Mr Heng Chang, Tier 2 Branch, Chairman of the Labour Union, interview, 7th November 2012). In the meantime, product and service are key elements to attract individual VIP customers, which have become an important group for Chinese domestic banks. In the agreement with the Bank of America, CCB especially points out its key future mission is to develop VIP private wealth management. For individual customers, product and service play an important role. In this area, CCB came to realize the importance of customer service as well as developing new products. For example, CCB claims to be the first domestic banks to use the ticket service at its counters. Customer suggestions or feedback do help to improve service and to develop new products (Mr Li Lin, Sub Branch Vice Present, interview, 7th November, 2012). Due to the agreement with the Bank of America, CCB sent employees to visit the Bank of America every year. For example, in 2007, selected employees visited the Bank of America product development centre. After the trip, CCB leant from the Bank of America and built its customer experience centre. The purpose of establishing the customer experience centre was to invite customers to try pre-launched products, and directly to gain feedback from them on how to improve the product. In 2008, after visiting the Bank of America, CCB learnt how to develop financial products based on individual customers. CCB headquarters designs and develops the majority of products

and services, after the CBRC's approval (Li, 2013). The province level branch could develop short-term (under six month) financial products, such as those it introduced for large corporate clients and special requirements (Mr Shaoming Huang, Senior Clients Relationship Manager, 9th July 2013).

CCB has established Product Innovation Centres in Shanghai, Shenzhen, Xiamen and Suzhou in 2011. In the Product Innovation Centres, customers have been invited to experience new products. Then CCB uses customer feedback to improve products. For example, responding to customer feedback, CCB improved its design of the online security system. In 2011, CCB developed 372 new products, including basic financial products, credit and debit card business, and personal loans, particularly improving many products for electronic banking users (CCB annual report, 2011).

CCB gradually moved its the basic counter service towards self-service facilities, and put more effort into selling financial products (Ms Juan Yu, VIP Customer Relationship Manager, interview, 11th July 2013). In 2011, CCB established 5771 self-service facilities to provide a 24-hour convenient service to customers. Self-service has become one of the largest transaction service channels in CCB. For example, the transaction value reached 4.56 billion in 2011. Overall, customer satisfaction for the self-service facilities was 64.1% (CCB annual report, 2011). After visiting the Bank of America customer experience centres, CCB realized the importance of customer perceptions on developing retail business. CCB has established customer experience centres in five cities, which are Beijing, Shanghai, Chengdu, Xiamen and Guangdong. In the customer experience centres, CCB organize customer experience activities for new self-service facilities, and collect opinions and suggestions from customers to improve services, products and business operations.

Through the customer experience activities and feedback from branches, in 2011, CCB made improvements such as queue service numbers and customer identification systems. In 2012, the Bank's overall customer satisfaction rate reached 64.5%, which was 1.2 percentage points higher than the industry average (although 1.2% is not statistically significant) (CCB annual report, 2012). CCB offers student loans. However, this initiative did not take a large of amount of business. Due to the less developed personal credit system, it is hard to evaluate personal credit histories, leading to non performing loans (Ms Juan Yu, Customer Relationship Manager, Interview, 11th July 2013). CCB developed individual business loans to small and micro enterprise owners. By the end of 2012, CCB has provided RMB 101.776 billion to these groups of customers. Again, due to the less developed personal credit system, there is a limit to this business at CCB (CCB annual report, 2012).

In 2012, CCB started to expand its individual VIP customer services, including wealth management. CCB divides the VIP customer into different levels according to their savings. The first level is the basic VIP customer, whose savings is over 50,000 Yuan. The second level is for wealth management services, and for those with savings over 100,000 Yuan. The wealth manager service is mainly based on individual customer needs, providing wealth management planning, asset management, financial advice, and consulting services for investments. Moreover, the family members of the VIP customer could enjoy the benefits of financial products and credit cards. The top level is called private banking service, for those whose savings are over 300,000 Yuan. The private banking clients and their families could have special loan financing, cash management, investments, and financing private bank cards. The VIP customer can benefit from non-financial services, such as CCB would organize different social events based on individual interests, including events at golf clubs (Liu, 2013a). In Hunan Province, CCB has 12 private banking or wealth

management centres in selected branches. By the end of 2012, in Hunan province, the number of VIP customers increased to 4878, the total asset from VIP customers reaching 300 million Yuan (Mr Shaoming Huang, Senior Clients Relationship Manager, 9th July 2013; Liu, 2013b).

The state owned banks tend not to provide loans to small and medium enterprises as they consider them high risks compared to state owned enterprises or large corporates. The Chinese government encourages the development of small enterprises. Thus, the CBRC regulates that state owned banks have to provide loans to small to medium enterprise. CCB needs to support the development of small enterprise as a social responsibility commitment. At the end of 2011, CCB provided RMB913 billion loans to small enterprises, which indirectly helped create 20 million job opportunities (CCB annual report, 2011). CCB gradually realized that in a more competitive environment, large domestic banks and foreign banks tend to take a large share of business from corporate clients. Therefore, CCB is gradually moving towards a strategy to support small to medium enterprises. CCB started to develop and launch new products and services for its small enterprises clients. For example, in 2011, CCB developed the 'petty loan' products, which aim to provide a quick lending service to small enterprises. CCB's commitment to provide the best financial services for small enterprise has won itself wide recognition. However, the progress of providing loans to small and medium enterprises is still very strict. CCB learnt from its foreign partner, the Bank of America, how to manage and control risk. CCB provides basic financial services to small and medium enterprises, and introduces the owner of small enterprises to CCB's VIP customer and wealth management department (Mr Long Xu, Corporate Clients Manager, interview, 11th July 2013; Yang, 2013). In 2012, CCB implemented regulations to regulate and adjust the service fee on small and medium enterprises, as it has been criticized for high charges.

CCB developed special products designed for the small and micro enterprise. CCB developed the 'Credit loans', which is Renmingbi credit loan business for its small and micro enterprises (Luo, 2013).

In the area of client and customer relationships and product development, the impact from the foreign partner tends to be more significant. CCB leant how to build customer experience centres, how to develop products based on customer feedback and requirements, how to develop wealth management and private banking, and how to improve customer service from its foreign partner. The CBRC has also directly influenced customer relationships and product development. It regulates the percentage of business each bank needs to achieve the small and medium enterprises, which was not the main customer group for the CCB banks. Product development needs to be approved by the CBRC. The CCB headquarters develops the products. The province level branch could develop short-term products based on the customer requirements, but they must be it approved by CCB headquarters and the CBRC. Overall, since the reform, CCB has made significant improvements on product development and customer service.

5.5 Information Technology

For Teece et al. (1997), 'dynamic capability refers to the capacity to renew competences to achieve congruence with the changing business environment. Innovative responses are required when time to market and timing are critical, the rate of technological change is rapid, and the nature of future competition and the market are difficult to determine'. The integration of skills, knowledge and technology enables an organization to provide a particular benefit to customers. For example, advanced technology could help the development of

online banking, mobile banking, and self services facilities, thereby providing more convenient service to customers and improving the customer service and relationship.

CCB realizes the importance of information technology, and online banking service and mobile banking services. There are many reasons to operate those services, such as make up for when customer need service during off-working time, help to save labour time, also save customer's time in front of the counter. After 2003, CCB developed different kinds of online service. Basically, customer could transfer money and other traditional services in online banking. In 2012, CCB operates new section called: 'Happy Life' online banking service in majority of cities which customer could pay their bills such as electricity, gas, and phone bills through online. Customer could plan their trip through 'Happy Life' such as booking flight tickets and hotel. Also, customers could operate their financial service through 'Happy Life', such as buy shares or stock, fund financing stead investment, golden. Moreover, customer could appointment with local hospital through 'Happy Life'. CCB have its own online business shopping mall, which includes wide range of products from clothing to electronic and apply for personal loans, which their customer could easy to shop online and save transaction fees to third party such as PayPal. CCB launched SMS service along with online banking service to help customer to confirm its online service (CCB annual report, 2012).

Since 2012, CCB focus on their mobile service, most of smart phone could log in to their mobile banking and operate their service as similarly as online banking, and more easy and convenience to transfer money through personal phone. Customer only need to text with the amount of money and account number to certain service number, and then could easy transfer, or pay credit

card bills after operating this service (Mr Liang Gong, Tier 2 Branch, Electronic Banking Department Manager, interview, 10th July 2013). He further indicates that CCB specially focused on the development of online banking and tried to improve their online banking experience from customer feedback. In 2011, CCB collected more than 220,000 feedbacks from customers about their online banking or mobile banking service. CCB improved its service based on customer's opinions. CCB further intensified the channel building of electronic banking via the introduction of various transaction platforms, including personal online banking, corporate online banking, mobile phone banking, SMS financial services and internet website in order to provide customers with more convenient financial services at a relatively lower cost. CCB offers business consultation, financial management, and other non-financial valued-added services through online and mobile banking. Based on customer feedback, CCB designed nine products for online banking customers, which it called its e-commerce platform, and included mobile phone banking end-user and automatic fund receipts, personal online payment, and personal security products. Moreover, CCB has renovated its personal online banking service interface in response to the issues identified in the customer experience campaign consisting of more than 200 participants. Furthermore, to create a more convenient online banking service for small to medium enterprises, CCB provides capital market investment accounts with third party custodian contract signing service (Tan, 2013; CCB annual report, 2013). CCB focuses on the innovation of online banking or e-commerce development. Since, 2007, CCB has held e-commerce innovation national championship competition every year. CCB provides the event with prize, job opportunities for the winners or excellent participators. For example, in 2011, the championship involved more the 200,000 university students from 2800 universities. The price is RMB 250,000 for the winner, to encourage people participate innovation the service and products (CCB annual report 2011).

CCB specially developed online banking channel for small and micro enterprises. Clients could apply for loans and make payments through the online banking channel. For individual clients, CCB has introduced its ‘e-Account’ services, where customers could make a hospital appointment, process social security insurance, foreign exchange purchase, and treasury bonds services. In addition, CCB promoted electronic financial services through various channels, including online-banking and mobile banking. CCB brought in a new mobile banking user-end service, employed QR codes for financial products sales, and introduced new features for mobile banking clients such as ‘shake’ account balance inquiries, ATM cash withdrawal services and queuing status inquiries at CCB retail outlets. The launch of new products and services not only helps clients save time travelling to the retail outlets, but it saves labour costs.

CCB integrated new technological applications and improved back office management processes in order to meet customer needs for applying credit cards anywhere at anytime. CCB launched a series of electronic application channels that customers can apply for credit cards through the Internet, mobile phone, and tablet computer, SMS, email and telephone. CCB developed an emergency card issuing business process and operating procedures that met the urgent credit card needs of customers during their travel or study overseas. The credit card can be made and mailed on the day of approval in the case of emergency card issuing. Customers can receive new cards within three days at earliest. As a large number of customers requested to adjust their credit card limits during festivals, the Bank predicted the increased spending of customers based on data analysis and systematic detection in order to facilitate customers' spending in or outside China during Christmas, New Year or the 11 November Festival. The Bank took the initiative to increase the credit limits for 4.94 million customers. The Company specially provided SMS alerts

for over 40 service categories, including card mailing and payment due reminders. CCB has used Weibo to promote its products and services. It directly gains feedback from customers through Weibo (Mr Liang Gong, Tier 2 Branch, Electronic Banking Department Manager, interview, 10th July 2013).

In the area of information technology development, market demand plays an important role forcing the change of service channel in CCB. The impact from the foreign partner has been more significant, as one of the important agreements between the Bank of America and CCB is that the Bank of America needs to help with technology development. There are personnel from the Bank of America in the technology development departments of CCB headquarters. The CBRC has no direct influence but must approve all products and services. The development of multiple channel services provides more convenience for customers. CCB is committed to combining the development of its electronic banking operations with traditional counter service, by building up an expanded e-banking service network and increasing e-banking products and services.

5.6 Summary

After China joined the WTO, the entry of foreign banks was used to encourage further reforms in China's banking industry. The Chinese government established the CBRC in 2003, and CCB began a series of changes under the guidance of CBRC. According to interviewees, most of the significant changes and reforms happened after 2003. Therefore, the case reveals that the state institution is the leading force for the reform, but that the link with the overseas partner provided a useful resource to learn lessons on best practice. The other forces for change are the impact from the foreign partner and the nature of

market demand. The ownership structure changed. CCB became the shareholding China Construction Bank Corporation. The bank's major shareholders included state owned enterprises, private enterprises and foreign investors. CCB was in principle made accountable for its own losses or profits by law, and the Chinese government could no longer assume its bad debts. CCB was listed on stock market, which took the supervision from public. Although the Bank of America could take one seat at in the broad meeting, the CBRC regulates that the Bank of America could not participate in management decisions. A small number of personnel from the Bank of America work in the specialized department, such as online banking, or the technology department. However, those personnel have no management decision-making authority. At the province level, there are no foreign employees participating. From FDI theory, the foreign investor was looking to bringing its ownership advantages to the host economy. However, in the banking sector in China, with strong regulation from the CBRC, foreign partners have not been involved in management decision-making. The impact of the foreign investor has been noted in technology, management, and product development. The province level branch has limited authority to make decisions. Most of the management decisions are from CCB headquarters, approved by the CBRC. The province level branch acts as an agency, receiving guidelines from the headquarters, and implementing in the city level sub branches.

CCB restructured its HR systems after 2003. Significant changes included the switch from the ‘iron rice bowl’ to contracted employment and performance related pay and promotion systems. CCB emphasizes the training of their employees. Although strong influenced by the previous HR system, the improvements are still significant. One major concern of the HR system is the age related policy. CCB regulates that certain positions have age limitation, which lead to low incentives for people to work hard after certain ages. Another

concern is guanxi still playing an important role in recruitment and promotion. The training programmes largely enhance the general and specific knowledge of their employees, but the concept of 'service' still needs further emphasis in their training. The influence from the CBRC is direct on promotions, as above a certain level of senior manager they need to be approved by the CBRC. The CBRC indirectly influences recruitment, as the exam paper needs to be approved by the CBRC.

CCB gradually learnt the importance of customer relationships, and set the customer orientated principles, and seeks to improve customer service both from training employees and improving basic facilities. CCB learnt how to develop products from its foreign partner, such as establishing the product innovation centres. The use of customer feedback helps CCB to improve its product development, thereby improving its customer relationships, which can be regarded as a dynamic capability. CCB enhanced these factors from 2003, partly realizing the importance of customer services, and partly as it learnt from its foreign partner. In the area of client and customer relationships and product development, the impact of the multinational partner has been more impactful. CCB learnt about customer experience centres, developing products based on customer feedback and requirements, wealth management and private banking, and improving customer service. The CBRC has indirect influence on the operational level of product development. However, at the branch level, the concept of customer service has not fully transferred to every employee, which shows that more training is required. CCB realizes the importance of online and mobile banking services for new and improved customer services. For information technology development, the market demand acts as the major force for change.

As discussed above, CCB headquarters makes all the management decisions, and the province level branch act as the agency between headquarters and branch level. The province level has limited power to make management decisions. They can develop short-term products based on feedback from the branch level, but those decisions still need to go through headquarters and gain the permission of CBRC. The CBRC strongly controls management practice at the bank, and the centralized management decision making from the headquarters leads to low responses to the market. CCB was the pioneer in seeking a good reputation for customer service, but change has been partial. CCB needs to enhance its capabilities and build core competitive advantages to differentiate it from the other banks. The human resource management could be improved by ending the age limitations, and ceasing the remaining elements of guanxi in recruitments and internal promotion.

Chapter 6

The Bank of China

6.1 Background

The Bank of China (BOC) is one of China's four state owned banks. It is also the country's oldest bank, having been formally established in February 1912. Until 1949, its main function was as both the central bank and an international exchange and trade bank. The People's Republic of China was established in 1948. Since 1950, the General Management Department of the Bank of China was directly under the supervision of the People's Bank of China. In October 27, 1953, the State Administrative Council of the Central People's Government authorized BOC as a specialized foreign exchange bank. The main responsibilities of BOC were as the state-designated specialized foreign exchange and trade bank, responsible for managing foreign exchange operations, international trade settlements, overseas fund transfer, other non-trade foreign exchange services, and supporting the nation's foreign trade development and economic infrastructure (BOC, 2012)

In March 1979, during the first phase of banking reform initiated from 1978 onwards, the State Council separated BOC from the People's Bank of China. As in the case of CCB, BOC evolved into a commercial bank, although it acted under guidelines from the State Administration of Foreign Exchange. Since government continued to determine which products it could offer, BOC had no incentive to compete meaningfully. In September 1983, the State Council authorized the People's Bank of China as the central bank. Then the State Council separated the Bank of China from the State Administration of Foreign Exchange. In phase two of banking reform, from 1985 until 1993, the Bank of

China's main responsibility remained national foreign exchange business, under the supervision of the People's Bank of China. As with other state owned banks, it started to face competition from the new commercial banks. BOC's third phase of its development began from 1994, when three policy banks assumed major responsibilities for government projects. In early 1994, BOC was transformed from a specialized foreign exchange and trade bank to a state-owned commercial bank, and it expanded business by providing loans, savings, deposits and other services. In 1995, the Central Bank Law encouraged the four state owned banks to compete with each other and to pursue profit as a goal (Jiang, et al., 2009). As we have seen, the China Banking Regulatory Commission (CBRC) began in 2003 to address concerns about the bank industry's performance and failure to reform significantly, and determined BOC's critical fourth reform phase. The CRBC chose both CCB and BOC to be pilots for the development of more competitive banks, and sought address their lack of profitability. As with CCB, the lessons from BOC subsequently guided policy for other banks.

6.2 Strategic Control

From 2003, BOC started to restructure as a shareholding bank. Before listing on the stock market (September, 2005), BOC disposed of RMB 308.1 billion of NPLs, and the MOF provided RMB 141 billion of this sum (Hong Kong Stock Exchange Market, 2005b). Most of the non-preforming loans were transferred to Orient AMC. Therefore, by the end of 2006, NPLs were 4.04 per cent of total loans, compared to over 20 per cent in 2002. In August 26, 2004, the Central Huijin Investment Ltd took 67.75% of the Bank of China shares, and the Bank of China restructured as the Bank of China Limited. In 2006, at the requirement of the CBRC, BOC listed on the Hong Kong Stock Exchange and on the Shanghai Stock Exchange. BOC's business includes corporate banking,

personal banking and financial market services. The basic ownership pattern was established, and, as shown by the figures for 2006 and 2014, remained intact for eight years. A share presents that the stock was purchased from the Shanghai Stock Exchange, H share presents that the stock purchased from the Hong Kong Stock Exchange. The following list includes the top ten shareholders:

Table 6-1: Major Shareholders of BOC (2006)

Name of shareholder	Nature of shareholder	Total number of Shares held	Shareholder percentage (%)
Central Huijin Investment Ltd.	State-owned	171,325,404,740 (A shares)	67.49
Hong Kong Securities Clearing Company Nominees Limited	Foreign Investor	30,262,318,674 (H shares)	11.92%
RBC China Investment	Foreign Investor	20,942,736,236 (H shares)	8.25%
Asia Financial Holding Pte Ltd	Foreign Investor	10,471,368,118 (H shares)	4.13%
National Council for Social Security Fund (NSSF)	State-owned	8,377,341,329 (H shares)	3.30%
UBS AG	Foreign Investor	3,377,860,684 (H shares)	1.33%
Asian Development Bank (ADB)	Foreign Investor	506,679,102 (H shares)	0.20%
The Bank of Tokyo-Mitsubishi UFJ Ltd.	Foreign Investor	473,052,000 (H shares)	0.19%
Wingreat International	Foreign	420,490,000	0.17%

Limited	Investor	(H shares)	
Best Sense Investment Limited	Foreign Investor	236,526,000 (H shares)	0.09%
Turbo Top Limited	Foreign Investor	236,526,000 (H shares)	0.09%

(Source from: BOC annual report, 2006)

Table 6-2:Major Shareholders of BOC (2014)

Name of shareholder	Nature of shareholder	Total number of Shares held	Shareholder percentage (%)
Central Huijin Investment Ltd.	Stated-owned	189,179,033,607 (A-shares)	67.72%
Hong Kong Securities Clearing Company Nominees Ltd	Foreign Investor	81,614,000,276 (H-shares)	29.21%
The Bank of Tokyo-Mitsubishi UFJ Limited.	Foreign Investor	520,357,200 (H-shares)	0.19%
Huaxin Trust Co., Limited	Domestic non-state owned	124,931,383 (A-shares)	0.04%
Shenhua Group Corporation Limited	State-owned	99,999,900 (A-shares)	0.04%
Aluminum Corporation of China	State-owned	99,999,900 (A-shares)	0.04%
CSOP FTSE China	Foreign Investor	95,997,489 (A-shares)	0.03%
China Southern Power	State-owned	90,909,000	0.03%

Grid Co.Ltd		(A-shares)	
China Securities Finance Corporation Limited	State-owned	83,451,001 (A-shares)	0.03%
Wang Jingfeng	Domestic non-state owned	60,588,888 (A-shares)	0.02%

(Source from: BOC interim report, 2014)

In 2006, there are eight foreign investors among the top 10 shareholders, but each of them took only a small percentage. By 2013, most of the shareholders were state-owned firms. The most significant change was the decline of shareholders from overseas. The number of foreign investors reduced to three. The major non-state owned domestic shareholders are Dalian Huaxin Trust Co. Limited (0.04%) and China Universal CSI Index Securities Investment Fund (0.02%). The key shareholders are still Central Hujin Investment Limited. and Hong Kong Securities Clearing Company Nominees Limited (HKSCC Nominees Limited). Central Hujin has controlled more than 60% of shares since 2006 (BOC annual report, 2006).

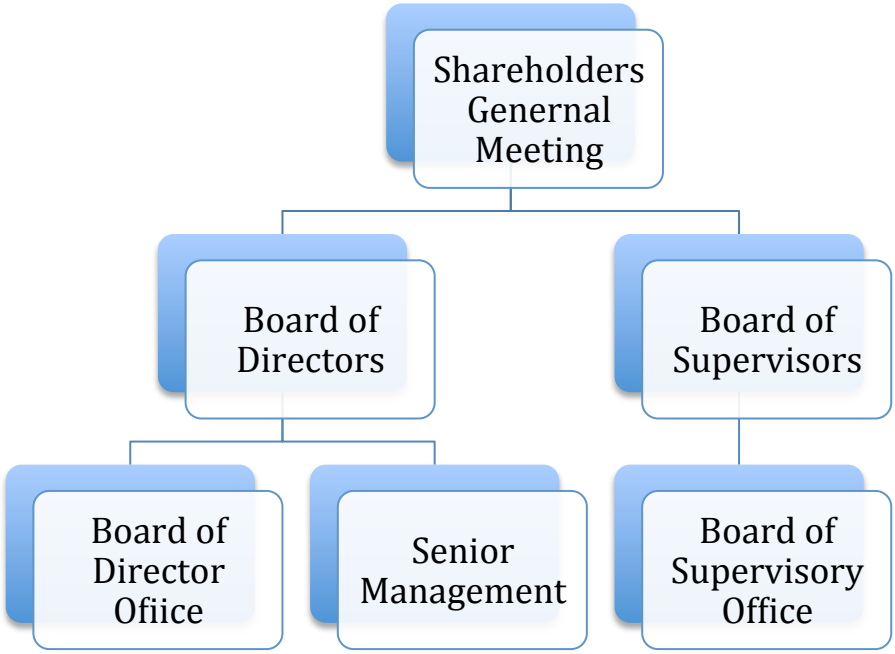
Despite the change in ownership structure, since 2006, the Board of Directors at BOC retained control of management decision-making, although, across the industry, the CBRC set the policy framework and had to sanction major decisions and appointments. Chinese state owned companies that assumed major shareholders were not expected to exercise operational control, and the foreign direct investment share was too small to determine management decision-making. Shareholders are limited to giving opinions at the

shareholder's general meeting, and exercising supervision and corporate governance. Linked to the change in ownership and objectives is the appointment of senior managers according to performance and examinations, with the final approval of the CBRC.

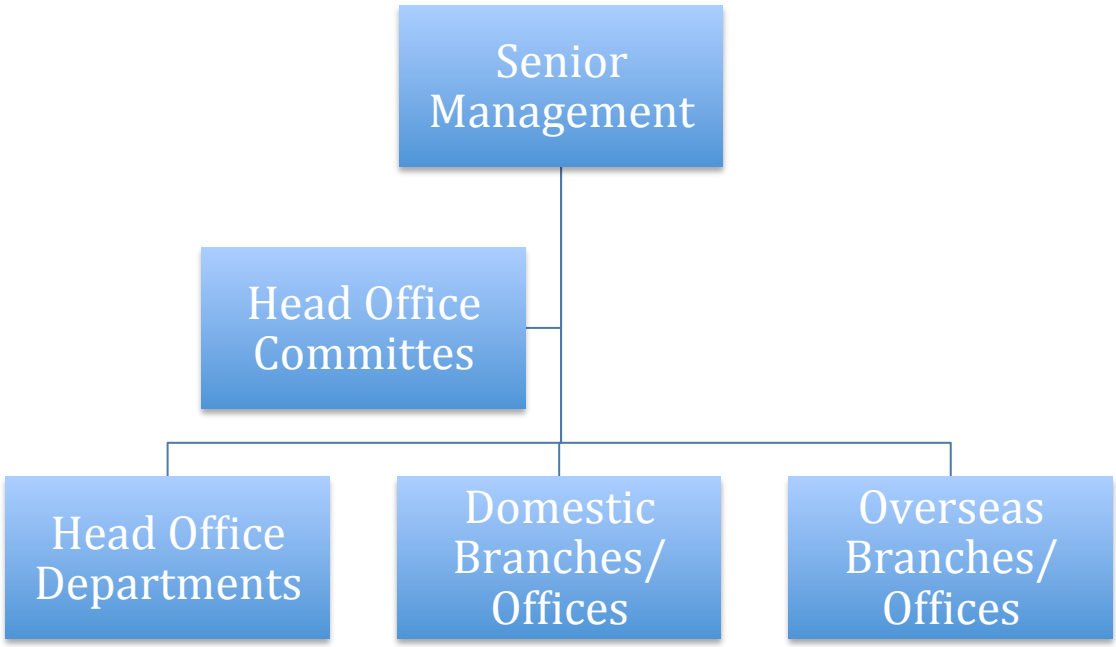
The management structure is presented in Figure 6-1. At the top are the headquarters and its departments, and below them the branches (Tier 1) in the provinces, the autonomous regions such as Hong Kong, and municipalities such as Shanghai. Each province or municipality has its own headquarters, and, typically for a state owned commercial bank, a human resource department, an information technology function, and a credit card centre. The company headquarters gives key instructions and sets the parameters for the provincial headquarters, which in turn sets policy at the level of the city branches (Tier 2). There is a similar pattern in the municipalities, which give the directives at the operational level of the urban district, just as autonomous regions in Hong Kong and Macau have parallel sub-branches. Decision-making within the provincial branches at BOC, as in the case of the autonomous regions and municipalities, is limited. The provincial, municipal and listed city branches have specialized departments at their headquarters, such as human resources, information technology, and credit cards, These branch headquarters and departments coordinate with the main office and supervise local operations. They also take direct responsibility for important corporate clients.

Figure 6-1: Organisational Structure of BOC

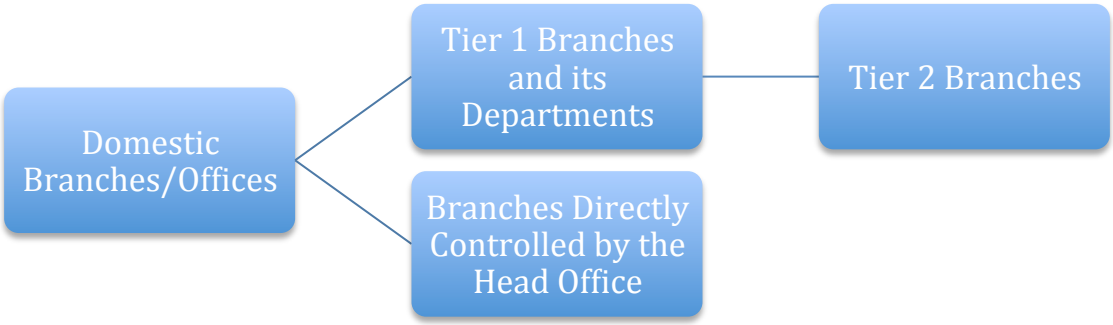
Shareholder's Level



Senior Management Level



Domestic Branches/Offices Level



(Source from: BOC annual report, 2013)

Since the founding of the CBRC, BOC considers that the cornerstone of a modern enterprise system rests with corporate governance mechanisms (BOC annual report, 2012). BOC is publicly committed to the improvement of its corporate governance in compliance with the PRC Company Law, PRC Commercial Banking Law and relevant requirements promulgated by regulatory authorities. The corporate governance framework of BOC is as follows： the shareholder's meeting is the authority of the Bank. The shareholders' meeting is responsible for making decisions on important issues, such as considering and approving the Bank's annual financial budget and financial statements, the profit distribution plan of the Bank, and selecting and replacing directors, shareholder's representative supervisors. The Board of Directors, under the management of the shareholders' meeting, is responsible convening shareholders' meetings and implementing the resolutions of shareholders; deciding on the Bank's strategic policies and business plans, reviewing and evaluation, and appointing or dismissing members of special committees and senior managers; and developing and reviewing corporate governance policies. The Board of Directors has set up the Strategic Development Committee, Audit Committee, Risk Policy Committee, Personnel and Remuneration Committee, and Connected Transactions Control

Committee to assist the Board in performing its functions. The Board of Directors comprises 13 members. There are 3 executive directors, 5 non-executive directors and 5 independent non-executive directors. The Bank's directors are selected at the shareholders' meeting, with a term of three years, and after the approval of the CBRC. A director may serve consecutive terms by re-election and re-appointment unless specified by laws, regulations and supervisory requirements (BOC annual report, 2013).

By the Company Law of the People's Republic of China, the Board of Supervisors is responsible for overseeing the Bank's financial activities and the legality and compliance of the Board of Directors and the senior management in performing their responsibilities. The Board of Supervisors has set up the Duty Performance and Due Diligence Supervision Committee and the Finance and Internal Control Supervision Committee to assist it in performing its functions. The Board of Supervisors has 8 supervisors, with 3 supervisor positions assumed by representatives of shareholders, 3 supervisor positions assumed by employee representatives and 2 external supervisors. A supervisor has a term of three years and may serve consecutive terms by re-election and re-appointment. Supervisors representing shareholders and external supervisors are selected or replaced by the Shareholders' Meeting. BOC needs to operate and carry out business activities according to the requirements set by the 'Commercial Bank Law of the People's Republic of China', as passed in 1995, and by the laws and regulations of the stock exchanges where it is listed. Until 2013, BOC provided a comprehensive range of financial services to customers across the Chinese mainland, Hong Kong, Macau, Taiwan and 28 countries (BOC annual report, 2013).

6.22 FDI

BOC selected the Royal Bank of Scotland (RBS) as its multinational partner. RBS, established in 1727, is one of the oldest banks in the UK. Its headquarters is located in Edinburgh, Scotland. RBS provides both corporate and commercial banking services to its customers. RBS supports its customers in accessing international markets in Europe, Asia, the Middle East and North America (RBS, 2014). In 2006, RBS purchased 8.25% of the shares in BOC, through its subsidiary RBC China Investment. RBS was listed as one of the top 10 shareholders. BOC allowed one representative of Royal Bank of Scotland to attend the Board of Directors, but the representative has no management responsibilities. BOC and RBS reached an agreement to assist BOC in risk management, governance, IT, wealth management, credit cards and corporate banking. For example, in the credit card business, RBS and BOC have a separate joint venture. RBS has a 49 percent ownership. The venture involves the RBS and BOC headquarters. At the provincial level, such as in Hunan, there are no personnel from Royal Bank of Scotland (Ms Luo Li, Tier 2 Branch HR Vice Managers, interview, 15th July 2013). In 2009, RBS sold its entire stake in Bank of China, for $2.34bn (BBC NEWS, 2009).

UBS AG is a Swiss firm, providing financial services to private, corporate and institutional clients. Its financial services include investment banking, asset management and wealth management. UBS AG is present in all major financial centres and has offices in over 50 countries (UBS, 2014). In September 2005, BOC and UBS announced that both of them would enter into a strategic investor arrangement. UBS would make a US$500 million equity investment in Bank of China, subject to a lock up period of three years. UBS AG and BOC intended to cooperate in investing banking and the securities business. In addition, UBS would share its skills, experience and know-how in

risk, asset and liability management with Bank of China (BOC annual report, 2005). In 2006, UBS AG purchased 3,377,860,684 shares in BOC, or 1.33% of BOC total shares, and it was listed in its top 10 shareholders. However, it has no Board representation and management responsibility in BOC. In December 2008, UBS AG sold out its shares in BOC, but retained its business relationship (Reuters, 2008).

Incorporated in 1974, Temasek is an investment company based in Singapore, and has 11 international offices (Temasek, 2014). In 2006, Temasek through its wholly owned subsidiary of Asia Financial Holdings purchased 10,471,368,118 shares in BOC, and took 4.13% of the total shares, so being listed in the top 10 shareholders in 2006, without any Board representation and management responsibility. In 2006, other main foreign investors included the Asia Development Bank, the Bank of Tokyo Mitsubishi UFJ Limited., Wingreat International Limited, Best Sense Investment Limited, and Turbo Top Limited. None of them were involved in any strategic partnerships, or had Board representation and management responsibility. Until 2013, most of these foreign investors were no longer in the top 10 shareholders lists; only the Bank of Tokyo Mitsubishi UFJ Ltd remained (BOC annual report, 2006; 2013).

6.3 Human Resources

The CBRC, as we have seen, guides Chinese banks to develop the 'best practice' of human resource systems, and the banks need to combine the advantages of the both western and Japanese style human resource practices and current systems in China. Under the stipulations of the Labour Law and Labour Contract Law, from 2003, two types of contract, specifically directly contracted employees and employees hired through agencies, replaced

lifetime employment. The introduction of the contract system helped BOC to downsize the number of employees. As in the case of CCB, all employees had to pass exams if they were to retain their current position; the results might mean employees were selected for an alternative position, training or both. For long-service employees, above 40 years old, and unable to pass the exam, BOC would allow them early retirement on pension. Sub-contracting was adopted for less skilled positions such as cleaners or particularly high skilled positions. The introduction of the contract system helped BOC to create the conditions to improve and change skills and the efficiency of the bank. By the end of 2012, BOC had 302,016 employees in total, which included 22,117 overseas employees (BOC annual report, 2012).

6.31 Promotion

The majority of key managerial staff are promoted internally rather than recruited from the local labour market, since they have experience and knowledge of the business. As a result, the iron rice-bowl SOE system has a measure of influence on promotion, as well as recruitment. BOC divides its employees into thirteen levels (apart from people the directors and chair person). For example, the first level is the headquarter department managers and the branch manager of the province branch. The second level is the headquarter department vice-managers and the province branch vice-managers. The third level is the department manager of the province branch and the second tier branch managers. The fourth level is the department vice manager of province branch and the vice manager of a second tier branch. Key managerial staff in or above the fifth level are directly selected and appointed by headquarters, subject to CBRC approval. Before their formal appointment at BOC, all candidates must pass written

examinations devised by the bank (Ms Luo Li, Tier 2 Branch HR Vice Manager, interview, 15th July 2013).

Other than the most senior province managers directly appointed by the headquarters, staff are appointed at the province level or within the city echelon. BOC evaluates the performance of candidates in previous years. Some positions can be through promotions without exams. Some positions require a pass of examinations set by BOC province branch, after which there are interviews. Some key managerial staff is occasionally recruited from the labour market. Each position has different requirements in experience or qualifications, and maximum age limits are set. BOC's promotion system remains influence by SOE practice, but a substantial difference is the introduction of examinations. Before 2005, promotion was almost entirely based on guanxi, but thereafter no employee could be promoted without passing an examination. Personal networks are likely to determine promotions, but every appointee must first have passed an examination for their position (Ms Luo Li, Tier 2 Branch HR Vice Managers, interview, 15th July 2013).

6.32 Recruitment

Parallel to the other state owned banks, BOC has four types of recruitment, which are graduate recruitment, targeted recruitment, open recruitment and internship. Graduate recruitment is the core recruitment method, and BOC prefers to hire full time graduates. The CBRC sets the process, and so there is a similar pattern for all state owned commercial banks. Therefore, students must apply online one year ahead of appointment, and all candidates must graduate at the year they are hire from a high-ranking university, achieve good grades, and hold a level 6 in the national English test (level 4 is the minimum

level for university graduates) or an IELTS 6. For some positions in the headquarters or at the province branch level, candidates must hold a Master degree. After applying online, candidates sit written examinations as set by BOC headquarters, and papers include English, Maths, administrative and professional skills, and knowledge and expertise. Once candidates have passed, BOC will select suitable appointees by interview. Li (2013) states that the introduction of examinations provides relatively fair opportunities for all candidates compared to previously. All candidates need to pass examinations, as the basic requirement, and candidates with strong 'guanxi' have no opportunity to be recruited if they fail to pass the examinations (Ms Luo Li, Tier 2 Branch HR Vice Managers, interview, 15th July 2013).

Targeted recruitment is similar to graduate recruitment in several respects, but the opportunities by this route are limited. Moreover, it allows the hiring of graduates from a university or college with relatively low entry requirements and awarding mostly diplomas rather than degrees. Similarly, as CCB, compared to graduate recruitment, grades or the university ranking criteria are less strict. Targeted recruitment provides more chance to provide positions for people with 'guanxi' or to employees' children (Mr Junping Liu, Tier 2 Branch Vice Present, interview, 15th July 2013). Open recruitment provides opportunities to the local labour market, and these jobs are advertised through the company website and recruitment agencies. The space for open recruitment is very limited, because BOC tends to promote their employees internally or to hire graduates. BOC reverts to open recruitment when it cannot find the appropriate candidate from amongst its own employees.

Every summer, BOC holds a summer internship programme (for three months) for students graduating in the following year. The internship programme,

introduced in 2005, shows how modernizing initiatives can have mixed results in circumstances where long-standing practices are deeply embedded. Candidates who are interested in the internship program need to apply, and at least pass a level 6 in the national English test (BOC annual report, 2005). BOC will hold interviews for suitable candidates. As with other banks, excellent students will have the internship experience when seeking to pass the basic examinations when attending the next year's formal graduate recruitment (Ms Luo Li, Tier 2 Branch HR Vice Managers, interview, 15th July 2013). The provinces or local branch internship recruitment does not need to be approved by the headquarters. Internship program is important in that it only provides opportunities for important clients' children rather than openly fair opportunities for all. One interviewee explains that, around 2012, BOC introduced examinations, even for the internship programmes (Ms Ting Feng, Sub Branch, Small to Medium Enterprise Department Manager, interview, 16th July 2013).

6.33 Training and development

The previous SOE system ignored the development of human skills. Since 2003, BOC has focused on the training and development of employees and helps them to plan their long-term career development and provide suitable career training. BOC provides different training programmes for different departments and positions. When launching new products or new services, the relevant department needs to attend training. The professionals or specialists normally give the training course, and they are internal trainers. Some courses such as English language and computer skills are supported and given by external professionals. BOC supplies information and training materials to learn about their latest product or service. New employees must attend induction training to learn their job responsibilities and to understand the firm's corporate culture and values. For senior managers, BOC holds senior

management training sessions in Hong Kong annually. It established an appraisal system for employees in its domestic branches, to determine the promotion of staff and to encourage career development. To provide incentives, the Bank changed its remuneration policies, and improved its performance management mechanisms. During the first half of 2013, BOC offered 25,831 training courses in total to its domestic employees (BOC interim report, 2013).

6.34 Pay policy and welfare

Part of the BOC pay and welfare system has been inherited from Chinese SOE practice. BOC's remuneration consists of 3 parts: basic salary, bonuses and welfare benefits. Basic salary follows seniority and grade. The pay rate formula is calculated on basic salary plus a local rate related to economic development levels. The bonus is linked to departmental and individual performance. Both length of service and grade determine welfare benefits as well as basic pay, in accordance with national, local and the Bank's internal regulations. Employees still have access to many benefits from the SOE system, such as house purchase, hospital, and childcare allowances and a child education scholarship. After the SOE reform, the hospital allowance and pension has been part of the national medical and pension system. BOC provides the basic pension, medical-care, unemployment, work injury and maternity insurance (BOC social responsibility report, 2013).

6.35 Summary

The BOC human resource system is a mix of the Chinese SOE system and initiatives influenced by western style HR. The CBRC directly sanctions the promotion and the appointment of senior managers, and indirectly influences

recruitment, payment, welfare, training and development for all staff. It approves all examination papers and training materials at BOC. In 2003, introduction of the contract system helped BOC to cut the number of employees, as, before signing any of the new contracts, BOC needed to select suitable candidates. Under the SOE system, employee's children could expect to work at BOC, and some of these traditions continue at the bank. As well as guanxi affecting the promotion of those that can pass the required examinations, graduate open recruitment allows some opportunities for hiring connected individuals. As state owned banks are seen as stable employers, offering good welfare and pay rates, BOC does not have a staff turnover problem. As with other banks, BOC has induction training, and provides a variety of training for different positions and levels. The training programmes generally enhance the general knowledge and specific knowledge of their employees. Compared to the other state owned banks, BOC tends to focus on the training of senior managers.

6.4 Client and Customer Relationships and Product Development

As in the other state owned banks, BOC divides its clients or customers into corporate, small to medium enterprise, individual VIP customer, and individual customer. Its corporate clients are important to its commercial operations; small to medium clients are less important than the other three. So, its profile is similar to the other state-owned banks. Developing new services and products for individual VIP customers has become a major aim for Chinese domestic banks, and guanxi plays an important role in developing and maintaining this group of customers. For individual customers, products and services tend to be the dominant role to maintain customer relationships.

As provided by other banks, BOC, firstly, improved the appeal, look and structure of its 10,145 sub-branches. Then, it concentrated on expanding its self-service facilities, including ATMs, to improve convenience and efficiency. Personal foreign exchange settlements and personal international remittances are one of BOC's traditional services, and one of its competitive advantages. BOC provides RMB and foreign currency remittance, personal foreign exchange settlement and sale, foreign exchange conversion, agency insurance and funds, and agency collection and payment to its individual customers. After BOC cooperated with its foreign investors, it built the brand reputation of 'Bank of China Remittance'. It aims to provide multiple channel services to its customers, and it has focused on transferring basic individual customer services such as money transfer to self-service facilities or to online banking services. Xie (2013) states that, in selected branches, BOC has employees especially to show customers how to use self-service facilities and to help them to operate their online banking services (Mr Yun Xie, Sub Branch VIP Client and Individual Customer Manager, interview, 16th July 2013).

BOC divides its individual VIP customers into three levels: individual VIP customers, wealth management customers, and private banking customers. It changed its management system and service by setting up a personal banking department. BOC tends to design marketing activities for targeted customers rather than in general. It introduced the 'direct-to-customer' marketing service to promote its online banking services. Similarly, the same as other state owned banks, and under the encouragement of the CBRC, BOC concentrated on developing its wealth management business. BOC is in strategic alliance with UBS AG to learn how to develop wealth management. Firstly, a separate sub department was established named 'Bank of China Wealth Management'. At the end of 2013, BOC has built 366 standardized wealth management centres, and over 1,000 wealth management offices and numerous wealth

management counters in selected branches. It trained more than 200 wealth management advisors and 2,500 wealth managers. As a member of BOC's wealth management, customers have extra benefits in Chinese domestic airports and with other cooperative partner with BOC. For individual VIP customers, whose personal financial assets are over USD 1 million, BOC provides more private, tailored, premium services and products (Mr Yun Xie, Sub Branch VIP Client and Individual Customer Manager, interview, 16th July 2013; BOC annual report, 2013).

Medium and small enterprise traditionally were not BOC's main clients, as the bank considered that small and medium firms were a higher risk than state owned enterprise. Even when state owned enterprise could not cover their loans, the Chinese government would always assist. Currently, the CBRC regulates the percentage of each type of banking business each domestic bank must achieve in the totality of its operations. Therefore, BOC started to improve its credit authorization and products for small and medium sized enterprises, and did so by learning best practices from its strategic investors. Firstly, BOC simplified the process of providing loans to small and medium enterprises, with the aim of providing more efficient and convenient services to them. Secondly, BOC used the feedback from these clients, and developed short term financing products. It also established a risk control management system for micro-sized enterprises in order to ensure fast service and decision making (Ms Ting Feng, Sub Branch, Small to Medium Enterprise Department Manager, interview, 16th July 2013).

Corporate business has always been one of the main businesses at BOC. In 2007, after listing on the stock market, BOC restructured the corporate banking department and its client information service system. In the history of

BOC, it has always been involved in foreign exchange and international trade, which are its competitive advantages. Therefore, BOC keeps expanding and improving its business cooperation with global financial institutions, and providing financial services in fields such as international settlements, bond financing, global cash management for multinational enterprises, and outward investments by Chinese firms. In the first half of 2013, BOC's foreign exchange deposits ranked first place amongst Chinese domestic banks. Incomes from the international settlement business were ranked first amongst Chinese domestic banks (BOC interim report, 2013). BOC continues to support public utilities, state health care, government life, and public education. It tries to broaden its corporate client base. Since 2013, under the guidelines from the Chinese government through the CBRC, BOC started to support emerging industries such as energy conservation and new energy industries.

Similar to other banks, BOC headquarters can develop products within the remit of CBRC regulations and with the approval of the CBRC. The city level branch has no authority to develop products and it can only report customer feedback to the headquarters. BOC's product development is based on client's feedback and CBRC requirements to provide for different types of clients and business. For example, BOC developed a series of trade financing products including Rong Yi Da (a financing service based on receivable accounts), Tong Yi Da (pledge issuing for receivable accounts), Rong Xin Da (a financing service based on receivable accounts for export credit insurance) and Rong Huo Da (cargo pledge financing) for its corporate clients. BOC introduced new products, including undisclosed export factoring and forfeiting under a bank guaranteed bill. In addition, in order to keep up with the change of mainstream settlement methods in global trade, BOC is the first Chinese domestic bank to join SWIFT's Trade Services Utility (TSU). BOC is the first Chinese domestic bank to introduce a series of payment products combining the services

provided by overseas and domestic branches, which includes "full payment without deduction", "Taiwan remittance", "priority remittance" and "special remittance service". BOC developed its ‘Idea Home’ products and services, by introducing fee-based services related to retail loans such as "An Xin Bao", a kind of entrusted escrow business for house transaction funds, and "An Yi Bao", a kind of entrusted management business for house transaction funds, based on further segmenting customers' demands. Also, since September 2012, BOC opened its office ‘weibo’ account to directly communicate with customers (BOC annual report, 2012).

BOC keeps enhancing the research and development, marketing, and service of its bankcard products. Based on different customer needs (such as business expenditure of domestic enterprises and public institutions, frequent travel, business travel and business procurement), BOC has developed different card products such as UnionPay Single Currency Great Wall Business Credit Card, Bank of China Phoenix Miles VISA Olympic Credit Card, Bank of China Ctrip Credit Card, and Bank of China Amway Credit Card. BOC has released market segmentation co-branded cards such as Bank of China-Dazhong Co-Branded Card, Great Wall-Ideal Home Co-Branded Card and Great Wall-China Life Co-Branded Card (BOC annual report, 2010; 2011;2012).

BOC continues expanding its traditional business in foreign exchange and international trade business, but its main incomes still comes from corporate clients. BOC uses its advantages for individual customers, and has focused on foreign exchange and financial products for them after improving its basic facilities and self-service systems. Small and medium enterprises are still not a main focus, but it has expanded its business for this group of clients by

simplified business processes and improving products and service. The leading changing force comes from the CBRC, as it regulates that the percentage of small and medium enterprise business that BOC needs to achieve every year. The CBRC encourages the development of wealth management for individual customers, and so products and services for high-end individual customers are a major strategic objective of domestic banks. Therefore, BOC is in strategic alliance with UBS AG to learn how to develop wealth management. This shows that in this case market demand is the leading force for changes; it demonstrates that it was the support from foreign partners that assisted the implementation of change. Products and services are still determined by BOC's headquarters, while sub branches are important to reporting customer feedback.

6.5 Information Technology

BOC integrated its information technology and core financial business to create a 'mobile, electronic, and intelligent' multiple channel service. BOC aims to provide seven days a week and 24 hours a day service to customers. It improved its self-service and ATM facilities to shorten customer waiting times at counters, to serve customers outside of office hours, and to increase the efficiency of internal operations. However, in reality, the online banking system fails, particularly during weekends and public holidays (Mr Ruoguo Cheng, Tier 2 Branch, Electronic Banking Department Manager, interview, 15th July 2013).

Customers criticize BOC's online banking system as it can only operate in Microsoft system. Many customers cannot use online banking if they are using iPad. Therefore, BOC improved its online banking system and launched a new application for the iPad, and made basic financial services, such as bill

payments, loan enquiries, and fund and foreign exchange trading, better integrated with different end user systems (Mr Ruoguo Cheng, Tier 2 Branch, Electronic Banking Department Manager, interview, 15th July 2013). BOC further enriched and improved its online banking functions, and separated corporate clients and individual customer online banking. It introduced new services to corporate clients such as supply chain order financing, SME loans, and foreign exchange quick settlement. BOC provides new personal online banking such as options, saving bonds, virtual credit card, precious metal deposits, and social security and public accumulation funds. For corporate clients, BOC added an online supply chain financing function to 'BOC e-Commerce'. It developed many payment products such as B2B direct payment, B2B guarantee payment and B2C interbank acquiring. These efforts helped to improve online payment processes and raise the success rate of account settlements. It improved personal online banking services such as fund transfer, credit card, and foreign exchange settlement and account management. BOC developed mobile banking to provide basic online transfer and balance check services. As with online banking, its mobile banking has limitations, such as iphone users not being able to access (Mr Ruoguo Cheng, Tier 2 Branch, Electronic Banking Department Manager, interview, 15th July 2013). BOC continues to develop its mobile banking services, and, at the end of 2013, most mobile users could use BOC's mobile banking services. BOC's telephone banking network could cover ten overseas branches in the Asia Pacific region (BOC annual report, 2013).

BOC continued to be driven by its commitment to technology-driven development and technology-guided financial innovation. Through its overseas information system transformation and integration project, BOC improved the functionality, operational flexibility, processing timeliness and risk control effectiveness of its current information system. It optimized its IT

infrastructure and operational maintenance system, thus improving the security of its IT operations and global service capability. The Bank capitalized on advanced technology and enhanced intelligent customer service, and differentiated service capability to improve customer experience. The Bank improved the online electronic innovation platform. It stepped up product innovation for its core banking system and launched personal intelligent call deposits, tiered interest calculation accounts, remittance packages, and password-based remittance (BOC annual report, 2013).

Market demand plays an important role in the use of information technology for service channels. Customer feedback helps BOC to improve its online and mobile banking platform. Learning 'best practice' from foreign partners is another important force in changing service channels. BOC further developed and enhanced its e-banking service channels, including online banking, mobile banking, telephone banking, and self-service banking. The CBRC has had indirect influence on the development of information technology at BOC. However, all online or mobile banking products and services need to be approved by the CBRC. BOC tried to improve its management system and business processes to provide faster services to customers. As a result, the number of e-banking customers increased steadily and transaction volumes increased rapidly, which contributed to a continuous enhancement of e-banking channels to replace traditional channels. For example, in the first half of 2013, BOC's e-banking transaction volume reached RMB50.86 trillion, an increase of 24.47% compared to the same period in 2012. The substitution ratio of e-banking channels for traditional outlets rose to 77.22% (BOC interim report, 2013).

6.6 Chapter Summary

The CBRC, since its establishment in 2003, has attempted to encourage a more market-oriented banking sector in China. BOC began a series of changes under the guidance of CBRC, and, according to interviewees, most of the significant changes and reforms at their bank happened after 2003. Therefore, the case shows that the regulatory and supervisory institution is the key factor for reform. Nonetheless, the link with the overseas partner provided a useful resource for acquiring best practices and acted as a source for change. BOC's ownership structure changed, and became restructured as a shareholding bank, named Bank of China Limited. BOC was in law made fully responsible for its own losses and profits, since the Chinese government could no longer write off its bad debts. BOC's major shareholders include state owned firms and private firms as well as foreign investors. Since it was listed on stock market, and until 2014, Central Huijin Investment Ltd was its key shareholder, and it controlled more than 60% of BOC's shares. One significant change is the decrease of foreign investor shares from 2006 to 2014. Despite the change in ownership structure, since 2006, BOC retains management decision-making autonomy, albeit under the aegis of the CBRC. Foreign investors have not been involved in management decision making, although they influenced the development of BOC, particularly in the area of technology development and product development. At the province level, managers have limited authority to make product or policy decisions. BOC headquarters makes the majority of management decisions, while the authority of the province level branch is limited, acting as an agency and following guidelines. Changes in ownership and objectives have brought an overall improvement in internal management, since senior managers are appointed according to performance and examinations, if subject to final approval from CBRC.

The main reason for the introduction of new human resource practices is the CBRC. BOC restructured its HR systems, and significant changes include contract employment and performance related pay and promotion. Since 2005, the labour contract system has helped BOC to downsize, and to create the conditions to improve, integrate and change skills. Examinations for promotion and recruitment ensure employees have the basic knowledge requirements for their position. Yet the age limitation for promotion and recruitment leads to low incentives for people to work hard when that pass the age limit. The CBRC directly influences the promotion of the senior managers, but has less direct involvement in the recruitment and promotion at lower levels. However, all exam papers are approved by the CBRC. Performance related pay is designed to incentivize employees. BOC provides training for its employees. It designs different training for different departments and different grades. Training programmes have expanded to increase general knowledge of banking and specific knowledge of posts. Similar to other banks, new human resource practices have become embedded in BOC, and helped to improve overall performance.

BOC has traditionally had a competitive advantage in foreign trade business and with institutional clients, but it has made gains in the area of retail banking business. BOC made efforts to improve its retail banking business. It started to improve its basic facilities, to provide training for employees to offer customer service to its clients, and to develop products meeting customer needs. The nature of market demand plays an important role in this development. The use of customer feedback is a tool to help BOC improve its product development and thereby maintain customer relationships. Foreign investors helped BOC to develop products and services. The CBRC has only indirect influence at the operational level of the product, but must approve the introduction of all products and services.

As for technology development, the online banking and mobile banking business are a common trend. Market demand is the leading force for the development of information and technology. BOC has focused on developing online and mobile banking business since 2005, along with telephone banking to provide multiple channel service to customers. Although CBRC has indirect influence on information technology development, all these services and products need to be approved by the CBRC.

Apart from the strength of conducting business in foreign and international trade, as well as with certain institution clients, BOC does not have competitive advantages in other banking areas, such as retail banking and including individual customers and VIP customers. Its multiple channel services have been improved markedly since 2013. As the CBRC gradually allows other banks to conduct business in the foreign and international trade sectors, BOC needs to improve its competitive advantages in many aspects of banking.

Chapter 7

The Industrial and Commercial Bank of China

7.1 Background

From 1978 to 1984, during the first phase of the banking reform, the main task was to separate firms from the regulator and the central bank. The Chinese government founded the Industrial and Commercial Bank of China (ICBC) on January 1st, 1984, and it was the last of the big four firms to be reformed. It took over some of the responsibilities of the China People's Bank, mainly commercial activities in urban areas. In 1985, the Industrial and Commercial Bank of China had already established branched in most of the provinces and cities in Mainland China. During 1985 to 1994, in phase two of the Chinese banking sector reform, the Industrial and Commercial Bank of China had the role of helping to grow state owned firms, and did so under the guidance of the government. As a result, ICBC became the leading bank in China. In 1993, its savings accounted for 42.1% of the whole Chinese bank industry (ICBC, 2014b). The third stage of Chinese banking sector change, from 1994 to 2002, pushed ICBC into the next phase of its reform. As we have noted, 1994 saw the creation of three policy banks, and from 1995, the Central Bank Law determined that banks should pursue profits and compete. A major aim at that stage was to control the non-performing loans and bad debts. The Chinese government helped ICBC to write off part of its bad debts, and ICBC has maintained its bad debts at 1.6% of the total since 1999.

The government acknowledged that Chinese banks still showed low performance and slowness in their reform, and that further reform would need help from government. China joined the WTO in 2002, and the government

agreed to open up the financial sector, and, in 2003, CBRC was appointed. It dealt first with CCB and BOC, and then turned its attention to ICBC, which entered its next phase of development

7.2 Strategic Control

7.21 Ownership

In August 2005, with the clear aim of creating a commercially orientated structure, ICBC was restructured as a joint stock limited company, differentiating it from its former status of wholly state owned commercial banks, It was formally renamed Industrial and Commercial Bank of China Limited on October 28, 2005. Before listing on the stock market (June, 2005), ICBC disposed of RMB 705 billion of NPLs, assisted by RMB 246 billion from the MOF (Hong Kong Stock Exchange Market, 2005a). Most of the non-performing loans were transferred to Huarong AMC. Therefore, by the end of 2006, they constituted 3.79 per cent of all loans, compared to above 20 per cent in 2002. The basic ownership pattern was established, and, as shown by the table 7-1 and table 7-2 for 2006 and 2013, it remained intact for eight years. A share refers stock purchased in Shanghai Stock Exchange; H share refers stock purchased in Hong Kong Stock Exchange. The following list includes the top ten shareholders.

Table 7-1: Major Shareholders of ICBC (2006)

Name of Shareholder	Nature of Shareholder	Total Number of shares held	Shareholding percentage
Ministry of Finance of the People's Republic	State-owned	118,006,174,032 (A-shares)	35.3%

of China			
Central Huijin Investment Ltd	State-owned	118,006,174,032 (A-shares)	35.3%
Hong Kong Securities Clearing Company Nominee Limited	Foreign Investor	43,222,318,000 (H-shares)	12.9%
Goldman Sachs	Foreign Investor	16,476,014,155 (H-shares)	4.9%
National Council for Social Security Fund	State-owned	14,102,149,559 (H-shares)	4.2%
Dresdner Bank Luxembourg S.A. (Allianz holds shares in ICBC through its Dresdner Bank subsidiary	Foreign Investor	6,432,601,015 (H-shares)	1.9%
American Express	Foreign Investors	1,276,122,233 (H-shares)	0.4%
China Life Insurance (Group) Company	Domestic non state-owned	809,266,000 (A-shares)	0.2%
China Life Insurance Company Limited	Domestic non state-owned	682,083,807 (A-shares)	0.2%
China Pacific Life Insurance Co., Ltd.	Domestic non state-owned	655,591,000 (A-shares)	0.2%

(Source from: ICBC annual report, 2006)

Table 7-2: Major Shareholders of ICBC (2013)

Name of Shareholder	Nature of Shareholder	Total Number of shares held	Shareholding percentage
Central Huijin Investment Ltd	State-owned	124,155,852,951 (A-shares)	35.33%
Ministry of Finance of the People's Republic of China	State-owned	123,316,451,864 (A-shares)	35.09%
Hong Kong Securities Clearing Company Nominee Limited	Foreign Investor	86,013,832,094 (H-shares)	24.48%
Ping An Life Insurance Company of China Ltd	Domestic non state-owned	4,474,434,462 (A-shares)	1.27%
ICBC Credit Suisse Asset Management Co. Limited	Domestic non state-owned	1,053,190,083 (A-shares)	0.30%
China Securities Finance Co. Ltd	Domestic non state-owned	806,536,828 (A-shares)	0.23%
An-Bang Insurance (Group) Company	Domestic non state-owned	540,842,624 (A-shares)	0.15%
China Life Insurance Company Limited	Domestic non state-owned	373,491,528 (A-shares)	0.11%
China Pacific Life Insurance Co.,	Domestic non state-owned	262,303,877 (A-shares)	0.07%

Ltd.			
Ping An Life Insurance Company of China Ltd	Domestic non state-owned	261,629,846 (A-shares)	0.07%

(Source from: ICBC annual report, 2013)

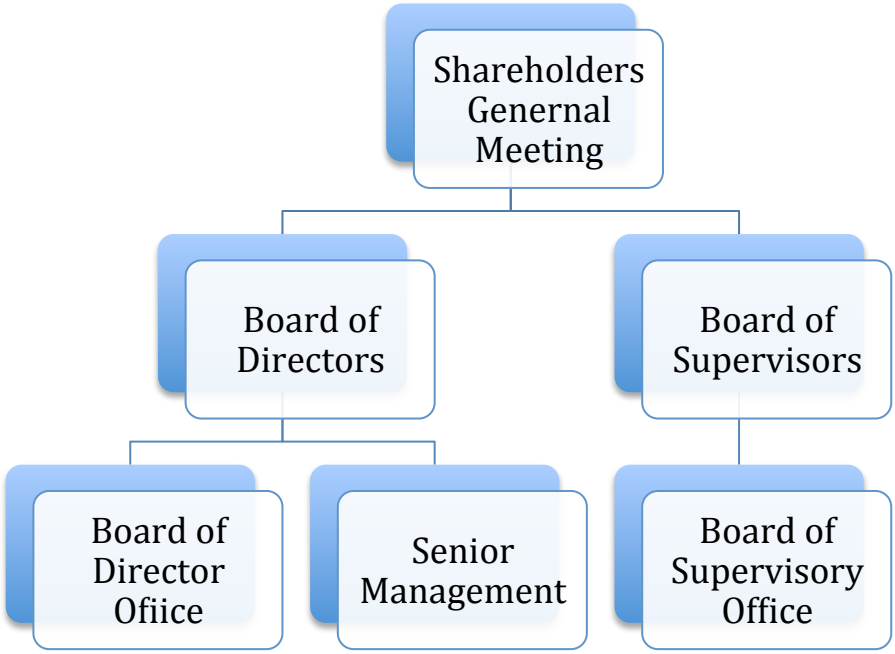
Huijin, a state-owned firm, and the Ministry of Finance took the large ownership shares (always above 35% each), by 2013. Most of the top shareholders are former state-owned firms, although each of their holdings is comparatively small. The major overseas shareholder in 2013 is Hong Kong Securities Clearing Company Nominee Limited. In 2006, Goldman Sachs had one representative on the Board of Directors, but could not influence management policy. One significant change from that time is the decrease in shares of overseas shareholders. Goldman Sachs (which had once held 4.9%), Dresdner Bank Luxembourg (1.9%), and American Express (0.4%) all sold up. Despite the change in ownership structure, the Board of Directors at ICBC retains the power of decision making (within CBRC's policy framework). Chinese state owned enterprises do not interfere in ICBC operations, and multinational partners do not and cannot have enough shares to determine policy. As in the other state owned commercial banks, shareholders exercise general governance, and attend shareholders' meetings (ICBC annual report, 2012).

ICBC's management structure, shown in Figure 7-1, demonstrates that there is a common structure in state owned commercial banks: the headquarters and its departments, branches in the provinces, municipalities, and autonomous overseas representative branches (Tier 1), plus the more local operational

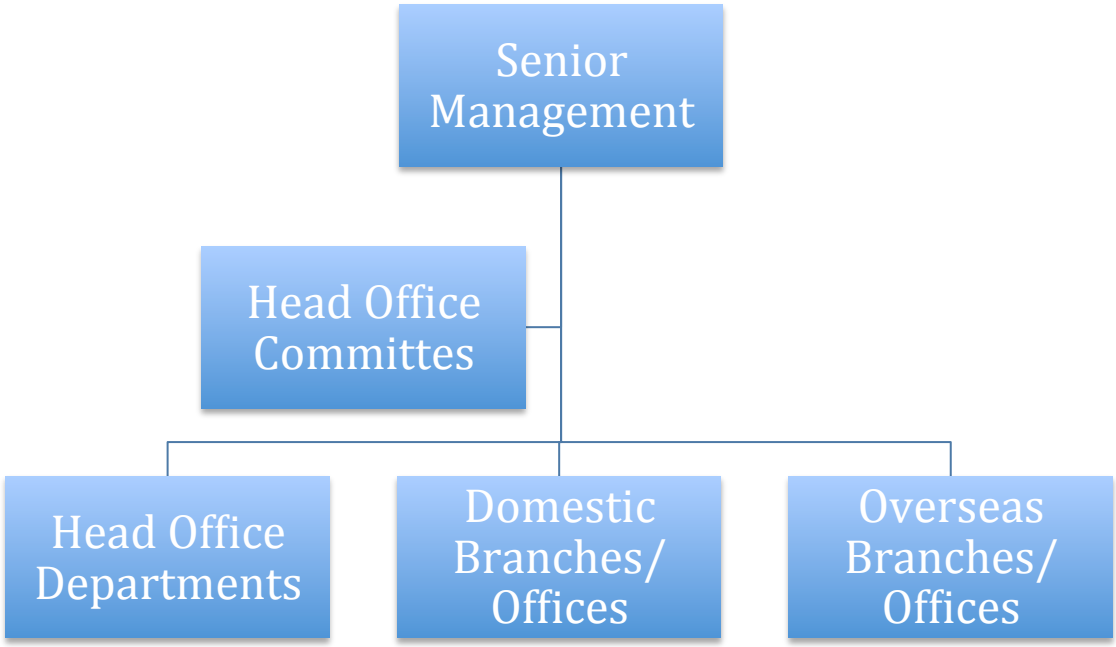
branches (Tier 2). Both the main company and the tier 1 branches have their own headquarters, with a human resource department, an information technology department, and a credit card department. Within the province, the headquarters follows the instructions and guidelines set by the company headquarters, and acts as the means for implementing policy. Decision-making within the provinces level is limited. ICBC headquarters makes the management decisions, with the approval of the CBRC. The provincial headquarters and departments coordinate with the main office, and, whole managing corporate clients directly, action policy in the city branches (Tier 2).

Figure 7-1: Organizational Structure of ICBC

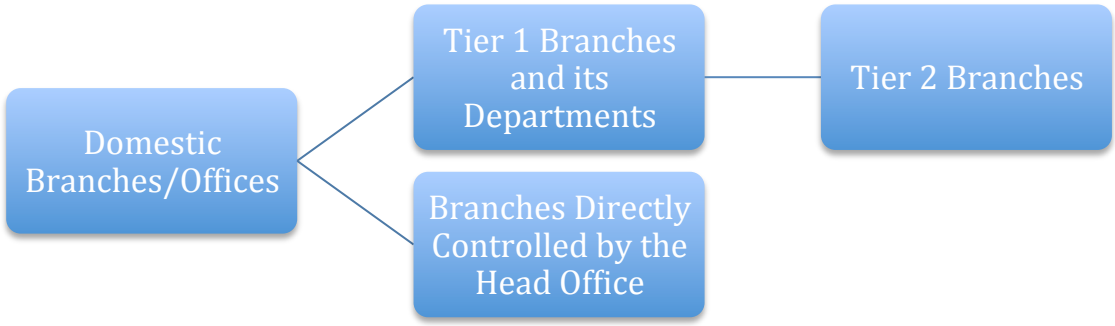
Shareholder's Level



Senior Management Level



Domestic Branches/Offices Level



As was claimed at ICBC, Jiangang Chen (2013), a Tier 2 branch president, states that the CBRC more strictly supervises state owned banks than non-state owned commercial banks (Mr Jiangang Chen, Tier 2 Branch Present, interview, 23rd July 2013). The CBRC monitors ICBC's Board of Supervisors, which is accountable to the shareholders' general meeting. ICBC believes that the maintenance of a high standard of corporate governance and the adoption

of an advanced corporate governance model by international standards is one of the key factors to develop the Bank into a pre-eminent international modern financial institution (ICBC annual report, 2006). ICBC has established and improved its organizational structure for corporate governance, consisting of the Shareholders' General Meeting, the Board of Directors, the Board of Supervisors and the senior management. The Board of Directors makes the strategic decisions, and consists of 16 directors, including 4 executive directors, 6 non-executive directors and 6 independent non-executive directors. ICBC has strict division of duties and separation of power between the Board of Directors and its senior management. The senior managers operate the business based on decisions from the Board of Directors. The Board of Supervisors takes the responsibility of supervision of the bank, and is accountable to the shareholder's general meeting. The Board of Supervisors consists of 5 supervisors, namely 1 shareholder supervisor, 2 external supervisors and 2 employee supervisors. (ICBC, annual report, 2013). The senior management is the executive body of the Bank is accountable to the Board of Directors, and consists of 8 members. They work on the basis that ICBC needs, under the 1995 Commercial Bank Law, to evolve into commercial banks.

In 2006, ICBC was listed on both the Hong Kong and Shanghai stock exchanges. In this period of its evolution, ICBC began to compete commercially and to offer shares, and started its international expansion, diversifying and expanding overseas, assisted by the 'Going Global' policy and RMB internationalization. It endeavoured to promote the endogenous development of overseas operations by providing a basic service to its clients globally. ICBC expanded its business in most of major financial centres around the world, such as Singapore, Tokyo, Seoul, Busan, Frankfurt and Luxemburg. By 2013, ICBC had established 329 operations in 40 countries, covering six

continents in Asia, Africa, Latin America, Europe, North America, Australia, and the major global financial centres. In 2013, the Bank ranked first place among the Top 1000 World Banks by *The Banker* magazine (ICBC annual report, 2013).

7.22 FDI

In 2006, ICBC signed agreements with the Goldman Sachs Group, Inc. The Goldman Sachs Group, Inc. is a leading global investment bank, and a securities and investment management firm, providing products and services to worldwide customers, which includes corporations, financial institutions, governments and high-net-worth individuals. The Goldman Sachs Group was founded in 1869. Its headquarters is located in New York and it has offices in all major financial centres around the world (Goldman Sachs, 2014). Goldman Sachs has extensive experience and expertise in risk management, treasury management and products, asset management and financing, coupled, it claims, with its consultancy in corporate governance and internal control. The motivation of ICBC to cooperate with Goldman Sachs is that it believes the American firm can assist with corporate governance, risk management and developing its banking business. Therefore, Goldman Sachs Group, Inc. (Goldman Sachs) and Industrial and Commercial Bank of China Limited (ICBC) had entered into definitive agreements with respect to (i) a strategic investment of U.S. $2.58 billion US dollar in newly issued ordinary shares of ICBC and (ii) Goldman Sachs helping ICBC to develop corporate governance, risk management and internal controls, and to provide expertise to help ICBC to improve its asset management, corporate and investment banking, non-performing loans disposal, and product innovation (ICBC annual report, 2006). ICBC ordinary shares purchased by Goldman Sachs were subject to substantial transfer restrictions that, among other things, halted any sale for at

least three years from the closing date. Goldman Sachs, as we have seen, had the right to nominate one director of ICBC. If Goldman Sachs held less than a total of 2.5% of ICBC shares, then it would lose the nomination right. In April 2006, Goldman Sachs subscribed for 16,476,014,155 shares, which equalled 4.9% of the total shareholding percentage. The initial term of cooperation was five years, and could have been extended or been subject to early termination by ICBC at any time. Until 2011, although ICBC net profit increased every year since 2006, it was considered one of the slowest growths amongst the big banks. Since then, Goldman Sachs gradually reduced its shares, particularly in April 2012, when it sold 2.5 billion shares, mostly to Temasek Holdings, the Singaporean sovereign investment firm. Therefore, Goldman Sachs has not been in the top 10 shareholders of ICBC since 2012 (ICBC annual report, 2012).

Allianz is a world leading insurance company and financial services provider. It was founded in 1890, and it was originally located in Munich. Nowadays, its headquarters is located in Berlin. Allianz provides insurance and asset management products and services to over 83 million customers in more than 70 countries. It includes a wide range of property, casualty, life and health insurance products for both private and corporate customers, It is the leading property and casualty insurer globally, and ranks among the top five in the life and health insurance business. In 1994, Allianz established representative offices in Beijing, Shanghai and Guangzhou. However, the representative offices in Guangzhou and Shanghai were closed in 2003 and 2008 respectively. In 2003, Allianz Insurance Company opened a wholly foreign-funded subsidiary insurance company with its headquarters located in Guangzhou. It mainly offers a series of insurance services including property, liability, marine, engineering, and domestic credit insurance, as well as short-term health insurance and accident insurance for clients within the

province of Guangdong, including Shenzhen. The motivation of Allianz to ally with ICBC is to expand into China. ICBC considers that Allianz has extensive experience and expertise in insurance business. It believes that Allianz is a valuable partner for ICBC to develop leading insurance products and services (ICBC annual report, 2006). Allianz subscribed for 6,432,601,015 shares, through its wholly owned subsidiary Dresdner Bank Luxembourg S.A., amounting to 1.9% of the total shareholding percentage. Allianz reached an agreement with ICBC to offer technical assistance for its insurance business, but without any management responsibility. Further to the joint press release by Industrial and Commercial Bank of China (ICBC) and Allianz Group (Allianz), issued on March 25, 2009, both parties reaffirmed their strategic cooperative relationship. Nonetheless, Allianz has sold 3,216,300,507 ICBC H shares, on April 28, 2009, to a selected group of investors through a private sale. Allianz continues to hold 3,216,300,508 H shares in ICBC. After the sale, the total shareholding by Allianz represents approximately 0.97 percent of ICBC's total outstanding shares. Its actions gained the support of regulators (ICBC annual report, 2009). In July, 2010, with official approval from the CBRC, Allianz Insurance Company Guangzhou Branch was permitted to transform from a branch to a subsidiary, and completed all legal processes, including the license application, and officially commenced operation in the name of Allianz China General Insurance Company Ltd. Since then, Allianz gradually sold its remaining ICBC shares. Two years later, in March 2012, the company opened its first branch in Shanghai. Allianz China General Insurance Company Ltd will be able to apply to extend its for branches across provinces, autonomous regions and municipalities outside Guangdong (Allianz, 2014).

American Express Company is a diversified worldwide travel, financial, and network service firm, founded on 1850. Its principal products and services are charge and credit payment card products and travel and business services. In

2004, ICBC became American Express' first card-issuing partner in China. ICBC considered that American Express had extensive experience and expertise in the credit card business. It believed that American Express is a valuable partner for ICBC to develop credit card products for its customers. In 2006, American Express subscribed for 1,276,122,233 shares of ICBC, which took 0.4% of total shareholding. American Express Company reached the agreement with ICBC to offer technical assistance for its credit card business, however, without any management responsibility. The motivation of American Express Company was to cooperate through ICBC's domestic network and to build new markets. Since then, American Express Company and ICBC have worked together and introduced more than 30 credit card products for individual and corporate customers in China. "This partnership provides us with the opportunity to cultivate the tremendous potential of the Chinese credit card market," said Jiang Jianqing, chairman and president of the Industrial and Commercial Bank of China (ICBC annual report, 2006). 'The profitable [initiatives] are going to be those that put credit cards in the hands of Chinese who travel abroad,' he added. Kenneth I. Chenault, American Express's chairman and chief executive, described the foray into the Chinese market as one of its broadest third-party alliances to date. He said that ICBC was already the country's largest card issuer. Under the arrangement, ICBC will market and issue cards with an American Express logo. Customers will be able to use the cards at any of the merchants in ICBC 's existing network as well as through merchants in American Express's international network. In turn, American Express will earn a percentage of every purchase, and its cardholders from other countries will have access to the merchants in ICBC's network (ICBC annual report, 2006). Until 2013, American Express still had a cooperative strategic partnership with ICBC, although the US firm was no longer one of its top 10 shareholders (ICBC annual report, 2013).

ICBC case indicates that it chose its partner by focusing on specific finance markets, and seeking partners that could help to develop specific areas, rather than choosing a commercial bank to help development in many areas. It chose Goldman Sachs for corporate governance and risk management, Allianz for insurance business, and American Express for its credit card know-how.

7.3 Human resource

As in the case of CCB and BOC, the new contract system that replaced life time employment on the instructions of the CBRC helped ICBC in downsizing the number of employees. Reform at the company started in 2005, with the founding of a human resource department, which was responsible too for upgrading skills and improving the bank's efficiency. To keep their current positions, all employees had to pass the relevant examination of knowledge and competence, or be transferred to another post or undertake training. Retirement was another option for long standing staff. ICBC took two further decisions. It hired many capable employees from other commercial banks (while also losing people to rivals). It sub-contracted out the employment of less skilled positions, such as cleaners, and particularly high skilled personnel, such as information system developers.

7.31 Promotion

Similarly, ICBC tends to promote its senior or key managerial staff internally (Mr Xueming Lu, Tier 2 Branch HR Manager, interview, 24th July 2013). There is a pattern in promotion in CCB, BOC and ICBC, and therefore the state owned commercial banks have followed closely the policy set by the CBRC. Internal promotion retains staff with experience and knowledge of the business, but tends towards guanxi and maintaining the iron rice bowl approach. ICBC

divides its employees into 25 levels. For example, the first level is the president of ICBC, and the second is the senior vice president of ICBC. The third is vice president. The fourth level is the president of the tier-one branch; the fifth level is the president of the tier-two branch. The tenth level is the president of the individual branch (ICBC annual report, 2013). Key managerial staffs at or above the fifth level are directly selected and appointed by headquarters, and need to be approved by the CBRC. Before their formal appointment, ICBC evaluates all candidates through written examinations devised by the bank, and all candidates must pass. Then, performance during the past years needs to be evaluated, and interviews are held at ICBC headquarters. From this point, ICBC adopted the state owned commercial bank practice in which 'guanxi' plays important role, and those candidates with political, personal or organizational support within their department or higher management are selected (Mr Jiangang Chen, Tier 2 Branch President, interview, 23rd July 2013). Appointments of key managerial staffs at the fifth level or below are appointed at the provincial or city level, as in CCB and BOC. ICBC similarly evaluates the performance of candidates over a period of years. Some positions can be obtained without examinations, but some require a pass in examinations set by the ICBC provincial branch, after which there are interviews. Occasionally, key managerial staff. Each position has different requirements in experience or qualifications, and there are additionally maximum age limits.

The CBRC has a strong influence on the appointment of the ICBC president and vice-presidents. It is accepted that ICBC's promotion system is still influenced by SOE practice and 'guanxi' (Ms Haojuan Zhang, Sub Branch, VIP and Individual Customer Client Relationship Manager, interview, 23rd July. 2013). What has made a substantial change – at the instigation of the CBRC in the industry – is the introduction of examinations. Before 2005, promotion was

almost entirely based on guanxi, but afterwards no employee could be promoted without passing an examination. While employees are likely to be promoted on the basis of personal networks, they must first demonstrate that they have reached the basic knowledge requirements.

7.32 Recruitment

In the same manner as the other state owned banks, ICBC has adopted the full range of recruitment strategies: graduate recruitment, target recruitment, open recruitment, and internship (Mr Xueming Lu, Tier 2 Branch HR Manager, interview, 24th July 2013; ICBC, 2014a). Graduate recruitment is the most important recruitment method. As in the other state owned commercial banks, ICBC hires full time graduates who must apply online in the year before their graduation, from a high ranking university, having achieved good grades, and holding a level 6 in the national English test or an IELTS 6. For some headquarters or provincial branch management, candidates must have a Master's degree. Written examinations are set by the ICBC headquarters and test English, administrative and professional skills, and knowledge and expertise. After the candidates have passed the examinations, ICBC will select suitable appointees by interview (ICBC, 2014a).

Targeted recruitment is similar to graduate recruitment, as we have seen, save that it accepts students with diplomas rather than Bachelor degrees from high ranking universities. These practices are referred to as target recruitment because they seek to fulfil a specific post, and because, as a legacy of guanxi, they allow the hiring of connected but less qualified individuals. The number of such posts however has been greatly reduced, and ICBC, like other banks, has to move towards graduate recruitment as the basis of its hiring strategy.

Open is aimed at the local labour market, although ICBC tends to promote their employees internally or hires graduates. ICBC resorts to this approach when it cannot find suitable candidates from amongst its own employees, which is reflected at CCB and BOC (Mr Xueming Lu, Tier 2 Branch HR Manager, interview, 24th July 2013). ICBC has held, since 2005, an internship programme during summer for students intending to graduate the following year. The state owned commercial banks, as we have discerned, chose graduates through entrance examinations, but the internship will be an important consideration in the selection criteria after the examinations. The headquarters runs its own internship programme, and the provincial or local branch internship opportunities do not need to be approved by the headquarters.

7.33 Training and development

Since 2005, ICBC has focused on training and development, and on helping employees plan their long-term career development. New employees need to attend induction training. Then ICBC divides its employees into three categories: administrator and manager, professionals and business representatives. For different levels and positions, ICBC organizes different types of training. The course formats include face-to-face training, online education for twenty major training programmes, and a digital library. Since 2007, ICBC has focused on the professional employees' development, and on employees achieving international certificates in varied aspects of banking. ICBC attends to middle-aged employee development and to their attaining professional skills. Since 2011, ICBC has selected employees and sent them to top overseas universities or internships with foreign firms, including Morgan Stanley, and cooperation with many top universities such as Cambridge and Stanford. By 2012, 267 employees have attended these programs and 157

employees have successfully graduated from overseas institutions. In 2012, ICBC provided 36,000 training sessions to employees in total (ICBC annual report, 2012).

7.34 Pay policy and welfare

ICBC's pay and welfare system retains elements inherited from Chinese SOEs. So, pay is based on seniority and position-related pay system, plus an annual performance-related bonus. The pay rate and welfare benefits are additionally related to the economic development of each locality. Both length of service and position determine the basic salary and welfare benefits. After the reform of the SOE system, employees relied on general government hospital and pension systems, for which ICBC would meet the fees or contributions. ICBC participates in local social insurance schemes for basic healthcare and basic pension, and it pays for unemployment insurance, industrial injury insurance, maternity benefits, and a staff housing provident fund. To improve protection for medical care in retirement, the bank has corporate annuity and supplementary medical insurance. Furthermore, different branches and sub-branches have established childcare subsidies. ICBC always organized social events and sporting activities, including parent-child activities and athletic meetings to enrich an employee's off-the-job life, and to relieve work pressure. By the end of 2012, ICBC had established 504 service departments for the care of retired employees (ICBC social responsibility report, 2012).

7.35 Summary

The current ICBC has the characteristics of CCB and BOC: it mixed the old SOE system with international practices. The change in the nature of staff contracts, as introduced in 2003, replaced lifetime employment, forced staff to

pass a competency examination, and brought about examinations for recruitment and promotion. Yet guanxi influences the selection process after individuals have passed the requisite examination. At ICBC, targeted recruitment specially hires employees' children or people with 'guanxi'. The key significant change after the reform is training and development. As in other banks, with the expectations of the CBRC, ICBC conducts induction training, and it provides programmes different positions and levels. Compared to the other state owned banks, ICBC has shown greater inclination to send employees to study abroad or to gain work experience with overseas banks, where they might learn 'best practice'.

7.4 Client and Customer Relationships and Product Development

ICBC is no different from the other state owned banks in dividing its clients or customers into four types, categorized by corporate, small to medium firm, individual VIP customer, and individual customer. Corporate clients are responsible for a large part of ICBC's revenues, and 'guanxi' plays an important role in obtaining and keeping such clients. Small to medium firms are less important to its commercial operations than the other three, as they are for the other state owned banks. To attract and keep the relationship with individual VIP customer and individual customer, 'guanxi', product, and service quality have important roles, and tailor-made services and products are provided.

With the aim to improve the quality and efficiency of services to retail customers, ICBC implements the 'Big Retail' strategy. ICBC established a service policy framework to guide employees on how to provide customer

service. ICBC has a third party to investigate and evaluate its customer services and overall customer satisfaction, and to identify those factors that could influence customer's perceptions. This can provide a data support for improving customer service (ICBC annual report, 2012; 2013). As the same as other banks, ICBC invested in its sub-branches and implemented its 'customer-centric operation service system' to enhance and diversify service capability and its retail banking. At the end of 2012, ICBC has refurbished its 16,718 sub branches in the mainland of China. ICBC established service facilities accessible to disabled customers. In the meantime, it has concentrated on expanding self-service facilities, including ATMs. At the end of 2013, ICBC had 21,825 self-service banks and 80,501 ATMs in mainland of China. ICBC developed 'the ICBC Merchant Friend Club platform', which is based on a system to classify different levels of customers by their savings or loans. Based on customers' data collected through this system, ICBC could identify or expand the numbers of premium customers, and develop precise marketing activities. For example, ICBC targeted key customer groups, and promoted a coordinated marketing campaign for the public and private sectors to popularize its 'ICBC Salary Manager' payroll service. ICBC provided different wealth management products to different customers based on its data collection platform. With the same information, ICBC according to strict criteria implemented differentiated housing credit or personal loans to support the needs of borrowers. At the end of June 2014, the Bank had 449 million personal customers, including 9.29 million personal loan customers, representing an increase of 17.01 million and 0.55 million from the end of the previous year, respectively. According to statistics from the PBC, at the end of June 2014, the Bank ranked first in the domestic industry in terms of both the balance of personal deposits and personal loans, with a market share of 15.01% and 13.1% respectively (ICBC interim report, 2014).

Just as other banks, ICBC generally divided its VIP customers into three categories: basic VIP customers, wealth management and private banking business, depending on a customer's savings or loans. Different services and products are designed for each level. The CBRC further regulated the development of wealth management business and sought to mitigate risks. ICBC made greater efforts to develop and launch new wealth management products and services to customers, and to conduct related marketing activities toward new markets and customers. For example, ICBC launched specific marketing campaigns among target customers, and scaled up 'the Elite Club Account service' for them. ICBC provides individualized and specialized services to this group of customers, and established wealth management centers in selected branches. ICBC trained its employees to be qualified to offer wealth management services to customers. At the end of June 2014, 26,289 employees gained the certificate of Associate Financial Planner (AFP); 3, 944 employees gained the Certified Financial Planner (CFP). The total number of Elite Club Account holders reached 30.51 million at the end of June 2014, and the total number of wealth customers reached to 4.74 million. For example, in the Shanghai Branch, the project of "convenient receipt taking" was put into operation, which enables corporate clients to print their receipts on any self-help receipt printing terminal with their financial service cards and passwords linked to their accounts. It mitigates operational risks, saves a series of traditional procedures in the counter businesses, and reduces workload (ICBC annual report, 2013). Although ICBC made many efforts to develop products and services for its individual VIP customers, 'guanxi' is the key factor to attract and maintain this group of customers (Ms Haojuan Zhang, Sub Branch, VIP and Individual Customer Client Relationship Manager, interview, 23rd July 2013).

ICBC tried to extend private banking business and develop a network of channels covering nationwide high-end customer markets. It strengthened internet finance services by popularizing basic private banking services on mobile banking and internet banking platforms, as well as by releasing 'ICBC Private Banking', and it's WeChat service platform to build all-dimensional private banking product and service channels. ICBC located its global product research and development in Hong Kong Private Banking centre. ICBC improved its private banking management product lines and services by leveraging interaction with the Group's domestic and overseas institutions. ICBC was awarded the 'Best Private Bank in China' by *Finance Asia*. At the end of June 2014, ICBC had over 39,300 private banking customers and managed RMB675.7 billion worth of assets (ICBC interim report, 2014).

As CBRC sets the percentage of each bank's business for small enterprises, ICBC supports the development of small enterprise as a new business opportunity as well as a social responsibility commitment. It gradually realized that, in a more competitive environment, state owned banks, national commercial banks, and foreign banks all compete for large corporations as clients. ICBC started to adjust its business strategy, paying attention to small to medium enterprises and developing products, such as 'Petty Credit Loan' and 'Online Revolving Loan'. It strengthened services to SME clients by building an independent and complete system of SME credit policies, processes and products. ICBC provides all basic financial services to small and medium enterprises. Moreover, it made efforts to expand markets, by pushing forward business development among small and micro enterprises on the upstream and downstream of the supply chain, in special markets and industry clusters. At the end of 2012, the total medium, small and micro enterprise clients increased by 11.8% compared to 2011 (ICBC annual report, 2012). However, the process of providing loans to small to medium enterprises

is still very strictly regulated and time consuming (Mr Xin Xu, Sub Branch, Small to Medium Enterprises Department Manager, interview, 22nd July 2013). In 2013, ICBC enriched its system of all small enterprises and finance products by introducing pilot medium and long-term credit such as commercial housing mortgage loans and property building loans to small enterprises. It introduced the 'Easy Loan Corporate Card' business for small and micro enterprises, and provided unsecured 'petty credit loans' to small and micro enterprises. At the end of June 2014, the balance of loans to small (micro) and medium-sized enterprises reached RMB 4,548,905 million, including RMB 2,731,797 million to medium-sized enterprises and RMB 1,817,198 million to small and micro enterprises (ICBC interim report, 2014).

Service and products are important for maintaining the relationship with corporate clients, even if 'guanxi' tends to be more dominant. ICBC aims to meet the diverse and individualized financial requirements of customers. It continues to serve national institutional clients, including organizing the social insurance, housing allowance, education and medical care schemes run by government. It still funds the state's key development projects and it has increased loan extensions for new urbanization programmes, core and advanced industries, infrastructure, energy and natural resources, and modern service businesses. ICBC has supported the 'Going Global' efforts of Chinese state-owned companies, and developed cross-border trade finance. In 2014, ICBC organized the Treasury's electronic centralized payment system, and assisted fiscal and taxation system reform; developed platforms for the integrated social security and housing fund services in order to raise efficiency and improve customer experience; it implemented the national equities exchange and quotation (NEEQ) system; and it was among first firms to introduce a centralized clearing service for RMB interest rate swaps at the Shanghai Clearing House (ICBC interim report, 2014). At the end of June 2014,

ICBC had 5,032,000 corporate customers in total, representing an increase of 297,000 over the end of 2013. According to the statistics from the PBC, at the end of June 2014, the Bank ranked first in the domestic banking industry in terms of corporate deposits and corporate loans, with a market share of 11.8% and 11.3%, respectively. The total balance of corporate loans reached RMB 7,576,419 million, representing an increase of RMB 529,90m or 7.5% over the end of 2013. The balance of corporate deposits amounted to RMB 8,120,197m, an increase of RMB616,700 million or 8.2% from the end of 2013 (ICBC annual report, 2013).

ICBC seeks to use technological innovation for product development. For example, in 2012, it launched a number of products such as foreign exchange trading on a personal account, regular investment accounts, and gold purchases. ICBC emphasizes the development of its bank card business. It cooperates with American Express, and has developed a card that can operate in two currencies, for use all over the world, the transaction going through UnionPay in RMB and through American Express merchants globally in US dollars. Depending on personal saving and incomes levels, ICBC offers a Gold and General American Express card. Also in cooperation with American Express, ICBC promotes a card to Chinese customers based on incomes and savings and consequently with different levels of service and credit limits. Mobile and internet banking services are supplied to all American Express cardholders, with services including reminders of balance changes. At some point, these product approaches were applied to holders of the card provided solely by ICBC (ICBC annual report, 2012).

In 2012, ICBC launched a number of card related products or services, such as the Account Manager, the Lump Sum Remittance and Withdrawal by

Instalments, the Bank-Hospital Card, the JCB dual currency credit card, the credit-debit-in-one card, the ICBC-AXA co-branded card, and a two card account. ICBC bases its business offerings on large customer data, and seeks to match the card to targeted customers and their individual needs. The bank specially developed an 'Easy Loan' business credit card for small and micro enterprises. ICBC upgraded its services with a chip debit card systems, which improved the personal security of customers. By June 2014, ICBC was the No.1 credit card issuer in China (ICBC interim report, 2014).

As with the other state owned banks, ICBC designs and develops its own products. The provincial branch moreover can introduce short-term products (only available for six months) for retail and corporate clients. The city branch level can pass customer feedback to the provincial branch, and then on to the headquarters, to assist with product development. ICBC invites customers to view products pre-launch, and assesses their feedback directly. For example, in 2012, ICBC collected 355 customer feedbacks on new products. Since 2010, it has organized the 'ICBC Cup' or the National Competition in Innovative Design in Banking Products for university students. For example, in 2012, over 6,200 students participated in the competition, and more than 370 universities, such as Tsinghua University and Renmin University of China, were involved.

The Chinese government to take responsibility for commercial banking activities in urban areas originally established ICBC. Therefore, ICBC has competitive advantages from a large number of individual customers as well as large corporate clients in commercial, urban banking. Since the CBRC regulates the percentage of each type of banking business every firm must hold in the totality of its operations, especially for supporting small to medium firms and agriculture industries, ICBC accepts the importance of customer

relationships, and has improved services and products for small to medium enterprises. It has evolved in addition specialized services and products for high-end individual customers, a trend typical in domestic banks._ICBC headquarters must develop services within the remit set by CBRC. The branches have no authority to develop permanent products and focus on reporting customer feedback to the headquarters. ICBC has three main ways of collecting customers' feedback, with customers bringing their feedback to their local branches, third parties collecting feedbacks, or customers being invited to the pre-launch of new products and services. ICBC particularly focuses on the development of card business. ICBC and America Express introduced different types of credit cards for Chinese domestic customers. ICBC applied the approach it learnt from American Express to develop its own card business, showing the impact of a foreign partner on product and service development. Moreover, through introducing and improving information systems, ICBC could provide targeted marketing activities and products. 'Guanxi' still plays an important role in maintaining clients and customers, most obviously for large corporate and government clients.

7.5 Information Technology

ICBC, as have CCB and BOC have realized the importance of information technology development for online and mobile service and for self-service facilities. It has improved its online service system and launched its 'Online POS' product, which has made online transfer and other basic financial activities more convenient. ICBC diversified its online banking business to cater for corporate and personal customers. Since 2006, it has launched various new products such as an online shopping mall, online cross-border remittance, intercity account management, online account reconciliation between bank and corporation, and a bulk payment system for enterprises.

Since 2006, ICBC has put its online banking system in the three overseas branches of Seoul, Tokyo and Macau, a convenience to customers who work or travel to these countries. ICBC has improved the security of online banking system, with an E-banking password card, and security question validation and log-in (ICBC annual report, 2006). In the early stage of its online banking, ICBC encountered problems, as its system was not fully compatible with others or with Mac computers. Customers complained about the complexity of using its online banking services and about the levels of security. After nearly eight years of development, ICBC solved those difficulties (Mr Qin Zeng, Tier 2 Branch, Electronic Banking Department Vice Manager, interview, 23rd July 2013).

By the end of 2012, ICBC's e-banking exceeded RMB300 trillion, an increase of 17.2% compared with the previous year. Business conducted through e-banking was equivalent to transactions processed by 230,000 bank counters, so saving labor time and improving business efficiency. More than half of fund transactions and sales of wealth management products and 90% of foreign exchange trading and precious metals transactions were conducted through its e-banking channels (ICBC annual report, 2012).

ICBC developed its mobile financial services to allow transfers, withdrawals, and balance checks. By the end of 2012, ICBC mobile banking offered 74 services. Customer feedback was used to implement improvements (ICBC annual report, 2012). In 2006, ICBC launched new telephone banking services, such as telephone payment (BTOC), automatic payment and payment reminder services. The initial experiment occurred in seven branches, such as Tianjing. By the end of 2006, the service covered 33 domestic areas (ICBC, annual report, 2006). By the end of 2012, the telephone banking hotline 95588

answered more than 95% of calls from customer, and ICBC managed to answer over 90% of calls within 20 seconds. In order to meet the needs of customers who frequently work overseas or travel, ICBC launched services such as overseas iPhone mobile banking, the overseas electronic password device, the overseas co-branded card, overseas telephone banking for the global asset management and personal customers (Mr Qin Zeng, Tier 2 Branch, Electronic Banking Department Vice Manager, interview, 23rd July 2013).

ICBC piloted TV banking at its Jiangsu branch, which provided basic financial services such as account management, transfer and remittance. Customers could complete business transactions easily while watching television. To enhance its multiple service channels, ICBC launched Android internet banking, the mobile life client, cash withdrawal by mobile phone, corporate foreign exchange trading, internet banking for the Firefox or Google browsers, smart response to short message banking, and the self-service card issuing machine. ICBC diversified its insurance brokerage via internet banking and self-service equipment.

As well as facilitating account transactions, ICBC has utilized the Internet to market products. For example, in 2012, ICBC launched marketing and promotion campaigns through online advertising. ICBC has used social media, such as Weibo and Wechat, to collect customer's feedback. ICBC improved its branch queuing management system, its product appointment service and preliminary document filling service at the counter. It upgraded its customer data integration system in 2006. As a result, ICBC could cross-sell products and services between different departments. For example, a client with a private medium-sized enterprise account could be recommended for an

individual VIP customer account if personal savings reached the required standards (Mr. Qin Zeng, Tier 2 Branch, Electronic Banking Department Vice Manager, interview, 23rd July 2013).

In the area of information technology development, market demand and firm level initiative played the key role in pushing the change in service channels. Customer feedback helped to improve services, and ICBC could communicate with customers directly through social media. The CBRC has had less direct influence information technology development, and clearly so if compared to human resource management. ICBC has made continuous efforts to improve its e-banking, comprising of internet, telephone, mobile, SMS and TV banking. Until December 2013, 90% of individual retail customers could complete basic transactions through self-service facilities. The core competitive advantages of ICBC in information technology development are its innovations in TV banking, which can teach customers how to use self-service facilities. Furthermore, by the end of 2012, ICBC had launched Internet and telephone banking in 26 and 14 overseas locations respectively. ICBC used information technology to improve its management and human resource systems.

7.6 Chapter Summary

ICBC implemented its reforms from 2005, guided by the CBRC. According to interviewees, all of them recalled that the most significant changes happened after 2005, as a result of the CBRC as the supervisory institution. The other notable forces for change were the impact of a foreign partner and market and customer demand. The ownership structure changed from October 2005 onwards. ICBC restructured into a joint-stock limited company, and became responsible for its own profit and loss. In 2006, ICBC listed on both the

Shanghai and Hong Kong stock exchanges. ICBC's major shareholders included state owned enterprises as well as foreign investors, yet, in state owned commercial banks such as ICBC, managers remained in control. ICBC allowed one member from the Goldman Sachs to attend its Board Directors, but that person had no management responsibilities. However, ICBC did not allow Allianz and American Express to attend to the Board Directors. Although these foreign partners have not been involved in management decision making, they still influenced the development of ICBC, particularly in credit cards, insurance, technology, and product development. At the province level, managers have limited authority to make decisions.

The major leading force for the reform of human resource practice, as we have stated before, is the CBRC. Since 2005, the labour contract system, training, performance related pay and benefits, and examinations have transformed the system, The guanxi element in post-examination selection and in targeted recruitment remain, however, and the age limitation on promotions can have a deleterious effect on those whose chances of a higher post and salary have been lost. The CBRC directly sanctions the promotion and recruitment of senior managers. All examination papers, for all levels of appointment and recruitment, have to be approved by the CBRC.

ICBC traditionally had a competitive advantage in retail banking. ICBC sets its customer orientated principles, and the CBRC has had less influenced on its customer relationships and product development. The use of customer feedback became central to product development and thereby for maintaining customer relationships. Foreign partners are another important force in helping ICBC to improve its products and services. For example, America Express assisted ICBC in developing its card business. The CBRC has indirect

influence at the operation level, but all products and services need to be approved by the CBRC. Foreign investors such as Goldman Sachs, Allianz, and American Express have helped ICBC to adopt international standards and best practices. In technology development and in the online and mobile banking business, market demand is the leading force for development. ICBC has developed its online and mobile banking business since 2005, although the CBRC must approve all new products and services. ICBC emerged as the leading domestic banks, with the brand image of ‘a reliable bank that's always by your side’. It has competitive advantages in retail banking, individual customers and VIP customers, and corporate firms. ICBC has advantages in providing multiple channel services to customers through its well-developed online, mobile, telephone and TV banking.

Chapter 8 The China CITIC Bank

8.1 Background

The China CITIC Bank Corporation Limited (abbreviated as CITIC Bank) was founded in 1987, CITIC Industrial Bank, one of the earliest Chinese commercial banks. It is a subsidiary of the CITIC Group Corporation, formerly the China International Trust and Investment Corporation, a state owned investment company, established in 1979, and located in Beijing. The purpose behind the establishment of CITIC Group was to attract and utilize foreign capital, and to introduce advanced technologies and operational and management skills from outside China. The CITIC Group was a pilot of national economic reform and modernization. It currently owns 44 subsidiaries, including China CITIC Bank. CITIC Group has businesses both in financial and non-financial fields. Its financial businesses cover a full range of services including commercial banking, investment banking, trust, insurance, fund management and asset management. Its non-financial businesses include real estate, engineering contracting, energy and resources, infrastructure construction, machinery manufacturing and IT industry.

In phase two of the Chinese banking sector reform, from 1985 until 1993, designed to increase competition in the banking sector, the Chinese government allowed the establishment of new commercial banks. Therefore, CITIC Bank was established during this period. In the third phase of the Chinese banking sector reform, from 1994, the 1995 Central Bank Law encouraged all domestic firms to compete with each other in most fields of banking and to pursue profit as a goal (Jiang, et al., 2009). CITIC Bank grew

quickly, but did not become competitive because the four state owned banks remained dominant. As we have seen, the appointment of the China Bank Regulatory Commission (CBRC) in 2003 initiated the critical fourth phase of Chinese banking sector reform. The CBRC began with the China Construction Bank (CCB) and Bank of China (BOC) and it followed with the reform of other state owned banks. Then, in 2005, it was the turn of the large commercial banks to be reformed. CITIC Bank changed its name from CITIC Industrial Bank to China CITIC Bank in August 2005. In 2006, CITIC Group and CITIC International Financial Holdings Limited (CIFH) were the top two shareholders of CITIC Bank. In 2006, Banco Bilbao Vizcaya Argentaria S.A. (BBVA), a leading bank in Europe, and a significant multinational, most notably in Latin America, invested in CITIC Bank and established a strategic cooperative relationship. In 2007, CITIC Bank listed on both the Shanghai and Hong Kong stock exchanges. In the past two decades, after the four state owned organizations, China CITIC Bank has grown to be one of the biggest commercial banks. CITIC Bank operates in the corporate, retail, international, treasury and capital, investment, auto financing, credit card and private banking businesses and sectors. By the end of 2012, CITIC Bank's business covered 130 countries and regions all over the world. It had set up 36 tier-one branches (based on each province), 60 tier-two branches (based on each city) and 789 sub branches (operational branch which directly deal with client) in China, which are mainly located in coastal areas in Eastern China and the economically developed cities of Central and Western China, with 41,365 employees (CITIC Bank annual report, 2012). By the end of 2013, the total number of branches had increased to 1,073 in mainland of China, and the total number of employees to over 46,000. There are three additional subsidiaries under the control of CITIC Bank, which are Zhejiang Lin'an CITIC Rural Bank, which mainly deals with rural business in Zhejiang Lin'an region; China Investment and Financing Limited (CIFL) in Hong Kong; and CITIC Bank International Limited (CNCBI). CNCBI is mainly concerned with international

business, and has over 1,700 employees and more than 40 branches or offices in Hong Kong, Macao, New York, Los Angels, Singapore (CITIC Bank annual report, 2013).

In 2012, CITIC Bank innovated their management philosophy, which is 'insisting on the coordinated development of profit, quality and scale', 'pursuing a risk-adjusted profit', 'seeking for a market capitalization with stable growth' and 'striving to take the lead among banks from home and abroad' (CITIC Bank annual report, 2012). Under the new management philosophy, CITIC Bank operates their business based on profit and market orientation. CITIC Bank strengthened capital constraint management and upgraded the assets management and internal management on a consistent basis in accordance with the Basel Accord and the requirements of risk management. Furthermore, CITIC Bank has made improvement in asset quality in recent years, and its NPL ratio is much lower than the average level of other Chinese banks. CITIC Bank ranked 185th among the '2010 Global Top 500 Enterprises in market value' released by The Financial Times of the United Kingdom. CITIC Bank, with a brand value of USD 2.342 billion, ranked 480th among the Brand Finance Global 500l brands in 2010, conducted by Brand Finance, a British brand consulting company (CITIC Bank annual report, 2010). In 2013, CITIC Bank was also ranked 57th in terms of total assets among the 'Top 1,000 world Banks' published by the Banker Magazine of the United Kingdom (CITIC Bank annual report, 2013).

8.2 Strategic Control

8.21 Ownership

Under the CBRC, from 2005, CITIC Bank restructured as a shareholding bank, named China CITIC Bank Corporation Limited. The basic ownership pattern was established and, as shown by table 8-1 for 2013. A share means shares purchased through Shanghai Stock Exchange market, H share manes shares purchased through Hong Kong Stock Exchange market. The following lists includes the top ten shareholders (2013):

Table 8-1 Major Shareholders of CITIC Bank (2013)

Name of Shareholder	Nature of Shareholder	Total Number of shares held	Shareholding percentage
CITIC Group	State-owned	31,325,081,973 (A-shares)	66.95%
Hong Kong Securities Clearing Company Nominee Limited	Foreign Investor	7,371,949,936 (H-shares)	15.76%
Banco Bilbao Vizcaya Argentaria S.A. (BBVA)	Foreign Investor	4,631,945,376 (H-shares)	9.90%
National Natural Science Foundation of China	State-owned	338,513,209 (A-shares and H-shares)	0.72%
China Construction Bank	State-owned	168,599.268 (H-shares)	0.36%
Mizuho Corporate Bank	Foreign Investor	81,910,800 (H-shares)	0.18%

Csop Asset Management Co.Ltd	Domestic non state-owned	42,643,092 (A-shares)	0.09%
China State Shipbuilding Corporation Limited	State-owned	35,172,000 (A-shares)	0.08%
China Credit Trust Co. Ltd.	Domestic non state-owned	31,219.052 (A-shares)	0.07%
Industrial and Commercial Bank of China	State-owned	31,034,400 (A-shares)	0.07%
Dongfeng Automobile Group Corporation Limited	State-owned	31,034,400 (A-share)	0.07%
Sinochem Group	State-owned	31,034,400 (A-shares)	0.07%
Hebei Construction Investment (Group) Limited	State-owned	31,034,400 (A-shares)	0.07%

(Source from: CITIC annual report, 2013)

CITIC Group takes the majority control of the ownership of CITIC Bank (about 61.85%, 2005-2013). Most of the shareholders are state-owned firms. The other state owned shareholders include the China Construction Bank, China State Shipbuilding Corporate Limited, Industrial and Commercial Bank, Dongfeng Automobile Group, Sinochem Group and Hebei Construction Investment (Group) Limited Liability Corporation. The major non-state owned

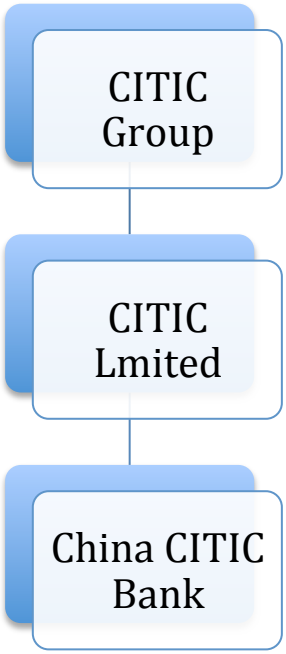
domestic shareholder is Csop Asset Management Co. Limited. The overseas shareholders include Hong Kong Securities Clearing Company Nominee Limited (15.75%), BBVA (15%, 2005-2012) and Mizuho Corporate Bank. The basic ownership pattern, established since 2005, remained intact for nine years. However, one of the significant changes is that the share of BBVA decreased from 15% to 9.9% in 2013, and the share of CITIC Limited increased from 61.85% to 66.95%. The Board of Directors at CITIC Bank remains responsible for decision-making, within the policy framework, although, as with other banks, some important decisions need the subsequent approval of the CBRC. Chinese state owned companies, which are shareholders, are not expected to interfere in the operations of CITIC Bank. Although Hong Kong Securities Clearing Company Nominee Limited and BBVA are amongst the top 10 shareholders; they cannot influence management decision-making, but can give opinions at the shareholder's general meeting. Under the new structures, the appointment of senior managers has become based on performance and examinations, if subject to the final approval of the CBRC. Two representatives of BBVA are allowed to attend the Board of Directors, but have no management responsibilities (see CITIC Bank's organization structure in Figure 8-1). CITIC Bank headquarters plays the guiding and leading role in market planning, policy guidance, information sharing, championing marketing efforts, technical support, product innovation, resource allocation and personnel training.

The management structure, as in Figure 8-1, shows, that below the headquarters and its departments are the Tier 1 branches at the level of the provinces and municipalities such as Beijing. As with state owned commercial banks, each province or municipality has its own headquarters, which includes a human resource department, an information technology function, and a credit card centre. Within the province, or Tier 1, the branch headquarters

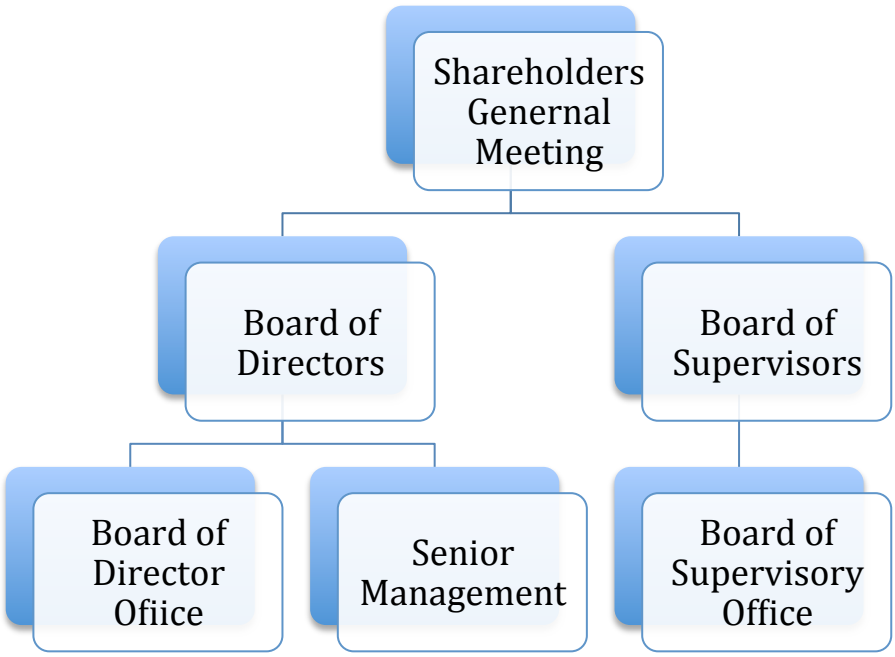
follows the agenda set by the company headquarters, and oversees at the city Tier 2 or sub-branches that deals with customers. The municipalities act similarly by carrying out the directives from above at the operational level of urban district. Decision-making within the provinces – as in the case of municipalities – is limited, and it is CITIC Bank headquarters that makes decisions in concert with CBRC approval. The provincial and municipal headquarters, as with state owned commercial banks, coordinate with the main office, and manage corporate clients. In the provincial level, such as in Hunan, there are no personnel from BBVA (Mr Heng Zhou, Tier 2 Branch, Vice President, interview, 6th November 2012).

Figure 8-1: Organizational Structure of CITIC Bank (2013)

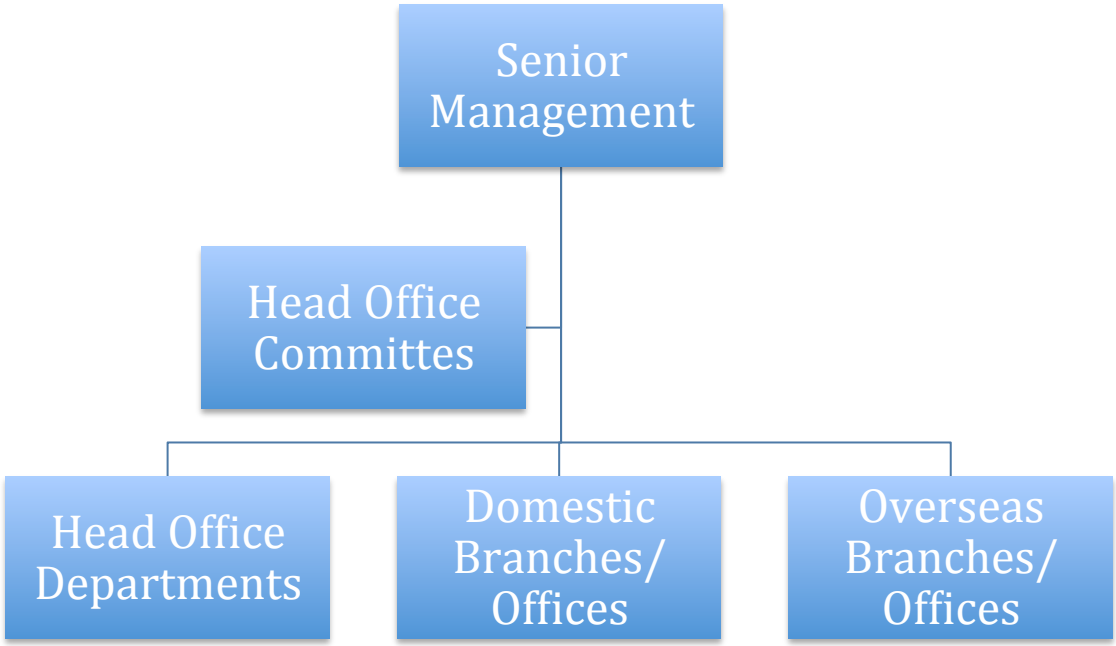
The Relationship Between CITIC Bank and CITIC Group



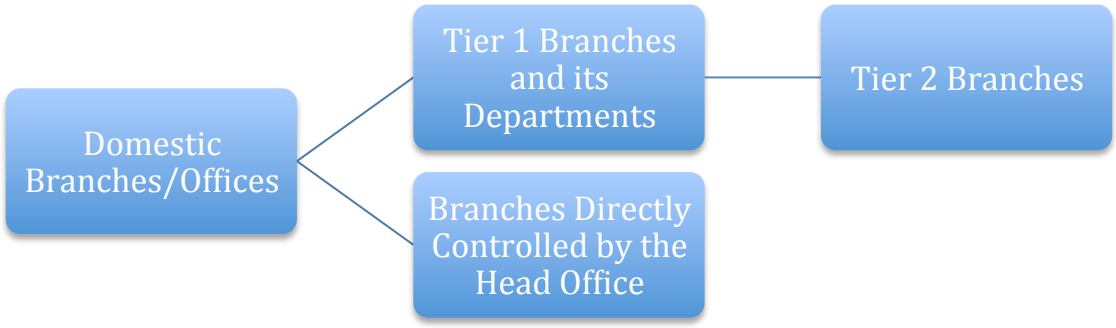
Shareholder's Level



Senior Management Level



Domestic Branches/Offices Level



(Source from: CITIC annual report, 2012)

The CBRC is charged with setting common standards for all banks, but the non state owned banks believe that the CBRC shows favoritism to state owned commercial banks (Mr Heng Zhou, Tier Two Branch, Vice Present, interview, 6th November 2012). The CBRC monitors CITIC Bank's Board of Supervisors, which is accountable to the shareholders' general meeting. CITIC Bank has established an organizational structure consisting of the Shareholders' General Meeting, the Board of Directors, the Board of Supervisors and the senior management (CITIC annual report, 2012). The Board of Directors makes the decisions of the Bank, and it consists of 15 members, including 2 executive directors. The senior management is the executive body and accountable to the Board of Directors. The senior management consists of 9 members. As we have in the examples of state owned commercial banks, CITIC Bank separates the power of the Board of Directors and senior management. The Board of Directors makes the strategic decisions, and senior management takes the day-to-day decisions based on policy set by the Board of Directors. The Board of Supervisors oversees the directors and senior managers and is accountable to the Shareholder's General Meeting. It consists of 5 members. One is a shareholder representative supervisor. Two of them are external supervisors. The other two are employee's representative

supervisors (CITIC annual report, 2012). In 2012, in addition to amending internal regulations such as the Measures for Management of Reputation Risk, the Measure for Management of Liquidity Risk and the Compliance Policies, the Bank formulated the Administrative Measures for Regular Reports Review and amended the Administrative Measures for Inside Information and Information Insiders in accordance with changes in relevant regulatory requirements for information disclosure management, improving the bank's corporate governance regulations (CITIC annual report, 2013).

CITIC Bank needs to operate and carry out business activities according to the requirements set by the 'Commercial Bank Law of the People's Republic of China', as passed in 1995, and by the laws and regulations of the stock exchanges where it is listed. In October 2007, at the requirement of the CBRC, and with aim of further evolving into a commercial bank, CITIC Bank was listed on the Hong Kong Stock Exchange. For depositors and other clients, as well as investors, listing was an outward symbol of its sound corporate governance structure. CITIC Bank began offer shares in Hong Kong.

8.22 FDI

In 2006, CITIC Bank signed a cooperative agreement with the Banco Bilbao Vizcaya Argentaria S.A. (BBVA). BBVA has taken both shareholdings in China CITIC Bank (15%) and CITIC International Financial Holdings (30%) (BBVA, website). By the end of 2012, BBVA held a total of 7,018,099,055 H-shares of CITIC Bank, representing 15.00% of the bank's total issued share capital. However, its shareholding had dropped to 9.9% by 2013.

BBVA was originally established in 1858 as the Banco de Bilbao. BBVA's international activity began as early as 1902, when it opened a branch in Paris. Nowadays, BBVA is a global financial group, and it has foreign partners or subsidiaries in many countries, such as in the U.S, Latin America, and Europe.

Particularly it is the largest financial group in Latin America region. Its business covers retail banking, corporate banking, international trade finance, global market, consumer credit, asset management, private banking, pension and insurance. BBVA has advantages in its significant size, a strong capital base, and appropriate geographic diversification of its business and risks. By the end of December 2012, BBVA had a market capitalization of EUR37.9 billion and total assets of EUR637 billion. It owned 7,978 branches, of which over 50% were located outside the territory of Spain (BBVA, 2014).

CITIC Bank entered into a strategic alliance with BBVA in order to improve its managerial skills, human resource management, information technology, product development, private banking service, car financing and knowledge of listing on the stock market. The motivations of BBVA are considered as expanding their business in China by using the network of CITIC Bank, and the strong growth of Chinese economy, which is creating profitable opportunities. CITIC Bank and BBVA have signed several agreements to cooperate and conduct business in cash management, international business, treasury and capital market business, financial services to small enterprise, investment banking, private banking, pensions, and insurance. In cash management, they reached agreement to both provide cash management services to strategic customers of BBVA. From this agreement, CITIC Bank learnt cash management practices, and also gained from sharing a customer with BBVA. In 2012, international settlements and trade finance transactions completed between CITIC Bank and BBVA amounted to USD 79,5918m and USD 622m respectively. With the help of BBVA, CITIC Bank has opened 11 cross-border Renminbi settlement accounts for BBVA in major Latin American countries. CITIC leant how to expand their business in international markets with the help of BBVA. In 2012, the transaction value of foreign exchange treasury business between CITIC Bank and BBVA was RMB34.656 billion, while the value of their derivatives transaction was RMB5.95 billion. In the area of financial

services, CITIC Bank and BBVA reached agreement to improve the credit granting process for small and micro enterprises, and quantitative risk control techniques and the construction of business operation platforms. They reached agreement to improve the private banking service in China, by learning from BBVA's private banking service in Spain. CITIC Bank also learnt how to develop pension business systems and products. Furthermore, they established cooperation over market research in China. For example, they analyzed commercial and affordable housing developments in China, and they produced the China Real Estate Outlook Annual Report 2012 (CITIC annual report, 2012). In the province level, there are no foreign personnel (Ms Changshun Jiang, Tier Two Branch HR Manager, interview, 19th July 2013).

It is interesting that the commercial CITIC Bank and the state-owned China Construction Bank both chose to have one major foreign partner, but CITIC Bank's approach was markedly different. It set out and was able to put into effect both a wider range and deeper levels of cooperation. While the state owned banks showed themselves to be more conservative and less open to change, the commercial CITIC Bank was more open to the opportunities available in its partnership with a foreign investor. The Industrial and Commercial Bank and Bank of China, on the other hand, selected multiple partners, with each one chosen supplying a particular expertise for different areas of banking business. While the expertise was more specific, the relationship with each partner was not so strategic and ultimately less stable. Of the major banks in our study, the CITIC-BBVA partnership had the greatest impact. As such, it demonstrates that within Chinese banking's strong regulatory environment firms could exercise different strategic choices capable of producing different competitive and organizational outcomes. In later sections, we will need to assess how influential BBVA was in the spheres of operations, human resources, training and customer relationships as well as

products and services, and how important its contribution was compared to other determining factors in the competitive evolution of CITIC Bank.

8.3 Human Resource

With CRBC's decision to alter employment contracts, from 2003, CITIC Bank has hired its own direct contract employees, but uses recruitment agencies to hire other staff. As with the state owned commercial banks, existing staff had to pass examinations appropriate to their roles, retrain or seek an alternative position, and in cases of those over 40 years accept early retirement. Low skill staff could be sub-contracted, as were some IT professionals. As a result of restructuring, CITIC Bank hired many capable employees from other commercial banks, particularly CCB. The introduction of new employment terms helped CITIC Bank to improve skills and enhance efficiency. By the end of 2013, CITIC Bank had 46,800 employees, of which 38,803 (82.87%) were under the two new labour contracts. Some 82.88% of employees held a Bachelor degree. CITIC Bank employed all staff in accordance with relevant provisions set out in the PRC Labor Law and the PRC Labor Contract Law (CITIC Bank annual report, 2013).

8.31 Promotion

While internal promotion keeps employees who are familiar with the business, CITIC Bank has hired people from other banks, in order to secure capable and experienced employees. Ms Changshun Jiang, a Tier 2 HR Vice Manager, said that most senior managers at CITIC Bank were hired from CCB, in order to facilitate expansion. She herself had worked in CCB previously, and had joined CITIC Bank in 2004 (Ms Changshu Jiang, Tier 2, HR Vice Manager,

interview, 19th July 2013). CITIC Bank headquarters directly select and appoint Tier 1 and Tier 2 branch vice presidents and above, and each appointment is approved by the CBRC. Before formalizing appointments, as in the case of the state owned commercial rivals, CITIC Bank assesses all candidates through written examinations, which all candidates must pass before the selection process still determined to a significant extent by guanxi. At this juncture, past performance is usually also evaluated, and interviews are held at the national or provincial headquarters in accordance with the position being considered.

Before 2005, promotion had almost entirely been based on guanxi. Jiang (2013) indicated that 'guanxi' plays a vita role when recruiting from external labour markets, as demonstrated by the fact that a large percentage of senior managers in Hunan province came from the China Construction Bank. From 2005, as appears to be common practice in Chinese banks, since the founding of the CBRC, no employee could be promoted unless they passed the appropriate examination, although guanxi still determined what happened to those who did pass. Other than those directly appointed by the headquarters, that is those below the Tier 1 and Tier 2 branch vice president level, the relevant branch has the authority to appoint their key managerial staff. Similarly, the relevant branch evaluates the performance of candidates. Some positions require a pass of examinations set by the provincial branch, followed by interviews; in other cases, the bank just appoints directly. Occasionally, rather than internal candidates, key managerial staff are recruited externally or are appointed by the CBRC. Each position in the organization has different requirements in experience or qualifications, and there are additionally maximum age limits.

In 2013, CITIC Bank further standardized the system for promotion and remuneration, and refined the Measures of CITIC Bank for Management of the

Internal Staff Hierarchy and the Measures of CITIC Bank for the Management of Categories of Technical Functions. CITIC Banks mainly classify their employees into three groups, which are managerial, expert and technical positions, and within each there are four levels, namely junior, intermediate, advanced, and senior. The criteria and professional orientation of technical positions in different categories were readjusted and improved. Promotions to technical positions mainly depend on their professional knowledge, technical competence, and performance; also, academic qualifications and career seniority are taken into consideration. Employees in technical positions need to pass exams and achieve the technical qualification certification, provided by CITIC Bank. Employees may only participate in performance evaluation for promotion purposes after completing on-the-job training and relevant examinations (Mr Guozhong Xie, Tier 2 Branch, Vice Present, interview, 6th November 2012).

The CBRC exercises strong influence on the promotion of employees at or above Tier 1 or Tier 2 level management. 'Guanxi' still plays an important role in an individual's progress, despite the fundamental introduction of examinations. Nonetheless, employees must first demonstrate that they can fulfill the requirements of the position. CITIC Bank claims that it provides equal job opportunities and equal promotion opportunities for all employees. Particularly, it claims that there is no gender discrimination against qualified female job applicants. The Bank states that it safeguards all legitimate rights and interests of its female staff, and does so in strict accordance with provisions set out in the PRC Labor Law and PRC Labor Contract Law. Female staff currently account for 53.09% of the total employees (CITIC social responsibility report, 2012). However, Ms Jiang (2013) indicates that, in practice, CITIC Bank tends to employ male employees in higher positions.

8.32 Recruitment

CITIC Bank undertakes – as we shall see, in the same manner as other non-state owned commercial banks - three types of recruitment: graduate recruitment, open recruitment, and internship. Open recruitment is the main method. CITIC Bank advertises these vacancies through the company website and recruitment agencies. Mr Guozhong Xie, a Tier 2 Branch Vice President, indicates that CITIC Bank prefers employees with working experience Mr. Guozhong Xie, Tier 2 Branch, Vice Present, interview, 18th July 2013). CITIC Bank does not have any formal policy on giving priority to the hiring of local candidates (local residents and people with local household registration). Mr Zhou, the Tier 2 Banch Vice President, states that, in reality, CITIC Bank tends to hire employees locally for the purpose of maintaining staff stability and due to 'guanxi' (Mr Heng Zhou, Tier 2 Branch, Vice Present, interview, 18th July 2013). As a result, 82.27% of senior management at branch levels were hired locally (CITIC social responsibility report, 2012).

CITIC Bank does hire full-time graduates. In the same manner as other banks, students must apply online one year ahead of graduation, and all candidates must graduate in the year they are hired. The entry requirements - high-ranking university, good grades, level 6 in national English test or an IELTS 6 – are standard for the industry. For some positions in the headquarters of Tier 1 branch level, a Master's degree is, as elsewhere, required. After applying online, candidates attend written examinations, set by CITIC Bank headquarters, including papers on English, administrative and professional skills, and knowledge and expertise. After the candidates have passed the examinations, CITIC Bank will select suitable appointees by interview (Mr Guozhong Xie, Tier 2 Branch, Vice Present, interview, 18th July 2013). In other words, the practices copy those set in state owned commercial rivals, and CITIC Bank seeks to follow the policy set by CBRC. Since the

introduction of graduate recruitment, and by the end of 2012, 26,506 employees, which account for 64.08% of the total, had bachelor's degrees; 5662 employees (13.69%) had a postgraduate degree or above. CITIC Bank organizes internship programmes, which provide opportunities for students who will graduate in the following year to learn about the banking sector (Ms Changshun Jiang, Tier 2 Branch HR Vice Manager, interview, 19th July 2013). Candidates interested in the internship programme need to apply online, and CITIC Bank will hold interviews for selected candidates.

8.33 Training and development

Since 2010, CITIC Bank has developed examinations that are directly related to job qualification criteria, and those seeking promotion must sit and pass the relevant examinations. CITIC Bank provides induction training, and thereafter organizes on-the-job training. CITIC Bank has developed a special leadership-training program for the general managers of sub-branches. Originally, this program was designed for newly appointed sub-branch general managers, focusing on improving professional skills and the handling of business operations, the management of teams, and responding to new markets. Therefore, since 2012, the leadership-training programmes become compulsory program for all sub branches general managers. In that year, the firm was responsible for a total of 4,171 training courses for all levels of employee. CITIC Bank has devised its own training systems and certificates. For example, in the risk management department, managers need to attend training courses, pass exams, and achieve a CITIC Bank Certificate of Risk Manager (CCRM). In the wealth management department, a CITIC Bank Certificate of Wealth Adviser (CCWA) is awarded. The bank developed the E-Learning system, and makes available online on-the-job training sessions for all employees. For example, in 2012, CITIC Bank organized 341 online examinations, covering all branches (CITIC annual report, 2012).

8.34 Pay policy and welfare

CITIC Bank's remuneration consists of the basic salary, a bonus and welfare benefits. Basic salary follows the established seniority and position-related system, and living cost calculations for differing provinces. The bonus is linked to departmental and individual performance. Mr Heng Zhou indicates that the basic salary is very limited, and that most of the income comes from the bonus, for which they have to work very hard (Mr Heng Zhou, Tier 2 Branch, Vice Present, interview, 18th July 2013). Welfare benefits follow the relevant national and local regulations as well as those of the bank. CITIC Bank provides insurance for the basic pension, basic medical-care, unemployment, work injury, and maternity (CITIC social responsibility report, 2012). Ms Changshung Jiang states that many employees consider CITIC Bank provides stable employment, good welfare provision, and competitive pay rates, most obviously so in the case of local personnel (Ms Changshun Jiang, Tier 2 Branch, HR, Vice Manager, 19th July 2013).

8.35 Summary

Since its introduction of the employment contract, in 2003, CITIC Bank was able to downsize the number of employees, select to a greater extent employee by reason of capability, and improve and change skills, all ultimately with the aim of enhancing efficiency. To further its rapid expansion and to move into new areas of business, CITIC Bank tends to hire employees with work experience, and, in particular, it favors recruiting senior managers from other banks. However, a significant number of senior employees have quit to join rival firms, which have themselves targeted experienced staff. It is not simply the loss of personnel: managers potentially take their clients with them. CITIC Bank relies heavily on local 'guanxi' or 'networks' in order to maintain and bring in new clients. One strategy for staff retention has been the hiring of local employees, and locally hired managers have a greater likelihood of

bringing their connections with them. Guanxi has a role furthermore in recruitment and promotion, firstly by encouraging needed personnel to join the firm, and secondly in deciding whom amongst those that pass the entry examinations are finally hired. Guanxi, similarly, is important in deciding the final cut of promotions from those passing the internal examinations for each post. Employees are likely at the last stage to be promoted on the basis of personal networks, having nonetheless demonstrates that they possess the basic knowledge requirements for their position. As have the state owned commercial banks, CITIC Bank has established training programs for different positions and levels, and provides job specific and general training. In a break with the SOE system, CITIC Bank uses the bonus to incentivize employees. The CBRC has directly influenced the procedures for appointing and promoting senior managers, and the content of employment contracts. The retention of the age limitation for each position remains and reduces incentives for senior employees who have no hope of promotion. Although notable numbers of managers have left for rival firms, overall staff turnover is not a problem for CITIC Bank, which is seen as providing stable employment, good welfare provision, and competitive pay rates, most obviously so in the case of local personnel (Ms Changshun Jiang, Tier 2 Branch, HR Vice Manager, 19th July 2013). Changing the structure of human resource management was one of the larger tasks, since practices had been deeply embedded within the previous SOE system. With guidance and compulsion from the CBRC, CITIC Bank was able to introduce important changes. In the HR function, the institutional context set by the CBRC has driven developments, and the systems to be found at different banks have a marked similarity.

8.4 Client and Customer Relationships and Product Development

As emphasized previously, a service firm has to interact with a customer directly and must develop effective client and customer relationships. Being linked, client and customer relationships and product development are key resources in the banking sector, from which firms can gain competitive advantage (Chen, 2009). Customer feedbacks develop products and service, and good products and service can help to attract customers and maintain client relationships. The client relationship and service development interaction is therefore a locale of dynamic capability – by moving from type or level of capability to another – and banks can consider how both networks and products can be enhanced and more deeply inter-related.

In 2013, CITIC Bank published its Corporate Culture Handbook, incorporating the concept of 'customer first, dedication to service'. In this mission statement, 'customer first' means that the Bank puts customers first, works on behalf of its customers, takes the initiative to understand customers, and helps customers address problems and overcome difficulties. 'Dedication to service' means that the Bank is grateful to customers for their custom and trust, and that it seeks to provide high quality, user-friendly services (CITIC annual report, 2013). CITIC Bank generally divides their clients into the four levels of corporate, small to medium firms, individual VIP, and individual client, as do its state owned commercial rivals. To attract corporate, SME, and VIP clients and to maintain good relationships, 'guanxi' remains a central consideration (Ms Yixuan Zhang, Sub Branch Individual VIP Customer Manager, interview, 17th July 2013). Nonetheless, product and service levels are viewed as important factors to attract individual VIP customers. Product development is based on customer requirements as well as market demand. CITIC Bank headquarters designs

and develops products, while the local branch passes back customer feedback and requirements to the headquarters (Mr Guozhong Xie, Tier 2 Branch, Vice Present, interview, 18th July 2013). The VIP customer business has emerged as an important and expanding trend in Chinese banking. For the individual customer, product and service play a more important role than guanxi. CITIC Bank has come to realize the rising importance of the larger retail market for individual customers in China, and it has concentrated on improving their customer service and products. For example, CITIC Bank develop different type of deposit accounts for individual customers, which offer loans for mortgages, cars, or tuition fees, and SMEs, which are seeking to expand their business (Mr. Heng Zhou, Tier 2 Branch, Vice present, interview 6th November 2012).

CITIC Bank implements the 'customer focus' business concept, and states that it puts customer service first in its retail banking business. CITIC Bank has developed personal housing mortgage loans and credit card loans as core businesses. By the end of 2012, personal retail credit loaned by CITIC Bank was RMB 320.044 billion, an increase of 26.07 % compared to 2011. CITIC Bank's deposit balances reached RMB 366.972 billion. CITIC Bank made efforts to promote its retail business through adjusting its bank charges and improving service. By the end of 2012, there were 33.12 million individual customer accounts, an increase of 13.1% over 2011 (CITIC annual report, 2012).

CITIC Bank expanded the distribution network of self-service facilities. In 2012, CITIC Bank established 1,572 self-service banks, and installed 5,306 units of self service equipment (such as ATM), and increase of 17.75% and 11.96% respectively over the end of the previous year (CITIC annual report, 2012). The establishment of self-service facilities, although improving efficiency, saved waiting time and improved service levels for individual retail customers

(Ms Yixuan Zhang, Sub Branch, Individual VIP Customer Manager, interview, 17th July 2013). The credit card business has huge potential in China. CITIC Bank has encouraged the credit card business and made efforts to develop and promote different types of credit card for different customers. At the branch level, Mr Zhou (2012) states that he did not push his employees to promote the credit card service. Many employees tried to reach their target, and offered a credit card to customers without financial checks, which has resulted in many non-performing loans (Mr Heng Zhou, Tier 2 Branch, Vice Present, interview, 6th November 2012). To develop the credit card business in China effectively, there is need for a better risk management system and supervision of employees.

The VIP individual customer is defined as having savings over 200,000 Yuan (it was 500,000 Yuan before 2013). Wealth management is for customer savings over 500,000 Yuan (1,000,00 before 2013). The private banking business is for customer savings over 6,000,000 Yuan (10,000,000 Yuan before 2013) (Ms Yixuan Zhang, Sub Branch, Individual VIP Customer Manager, interview, 17th July 2013). CITIC Bank launched its VIP Wealth Management Centers in 35 branches. In order to be responsive to customer demands, CITIC Bank offered products including equity investment and bank securities. By the end of 2012, CITIC Bank earned RMB 1.236 billion from wealth management fees. It has 18 categories of wealth management products. By the end of 2012, the total sales of its wealth management products reached RMB926.695 billion (CITIC annual report, 2012).

In 2012, CITIC Bank further provided its private banking service for premium VIP customer to help them ‘preserve wealth, create wealth’. CITIC Bank provides customer professional consulting and investment advisory services. CITIC Bank headquarters established an open platform for private banking products, with the aim of enhancing direct interaction between the

headquarters and branches, which could help to obtain customer feedback more quickly and to meet product and service demand. CITIC Bank consistently provides online and video training to private banking customer managers, and to team members to ensure they implement the headquarters strategy (Ms Yixuan Zhang, Individual VIP Customer Manager, interview, 17th July 2013).

CITIC Bank has strengths in regional marketing management for small enterprise development, for which guanxi is central to attracting clients. Many senior small to medium enterprise managers were recruited from other banks because they already have relevant business relationships and bought them to CITIC Bank (Mr Yang Zhao, Small to Medium Enterprise Manager, interview, 17th July 2013). Product and service are important to this group of clients. The new product specially designed for small enterprises included property mortgages loans, micro loans, and credit. By the end of 2012, CITIC Bank had 17,329 small enterprise clients, up from 1,957 in 2011, and the total loans to these customers reached RMB352.878 billion. The Bank has set up small-business operation and management centers. In 2012, CITIC Bank supported and provided loans to 14,132 small enterprises, worth RMB 191,333 billion, which accounted for 52.9% of the Bank's total business loans. In 2013, CITIC Bank made a strategic adjustment to its small enterprise finance business, prioritizing support to firms lending less than RMB 5 million. Mr. Yixuan Zhao, Sub Branch Small to Medium enterprise manager, states that 'the competition for medium enterprises was intensive. However, state owned banks tend to give less support to small and tiny enterprises, and, therefore, we focus on this group of customers' (Mr Yixuan Zhao, Sub Branch Small to Medium Enterprises Manager, interview, 17th July 2013). CITIC Bank designed and launched products for small and tiny enterprise finance business, such as 'CITIC Express Loan', 'Seed Loan', 'Trader Loan' and 'POS loan'. By the end of 2013, CITIC Bank provided RMB237.342 billion in loans to small

enterprises, an increase of RMB 53.511 billion (29.11%) over 2012, and RMB 41.889 billion to tiny enterprises (CITIC Bank annual report, 2013).

As well as focusing on the development of small to medium enterprises, CITIC Bank has developed its links with large corporate customers, by emphasizing innovation in product and service such as supply chain finance and cash management. CITIC Bank also adjusted the structure of loan allocation to customers. By the end of 2012, the total number of corporate clients was 309,700, increased from 25,700 accounts from 2011(CITIC annual report, 2012). Institutional banking business such as public utilities, health care, insurance, and educational establishments is important to CITIC Bank's corporate finance business. CITIC Bank specially designs marketing activities to promote the institutional banking business, and it claims that its strength are in a combination of 'team, product, program and system', through which it designs products, service, and information management processes. By the end of 2012, CITIC Bank had nearly 15,000 accounts of institutional customers, and 280 licenses for fiscal agency business at national or province level, covering 28 provinces. CITIC Bank as a commercial bank has a large variety of licenses for fiscal agency business, with the balance of deposits from institutional customers been RMB477.790 billion, which accounts for 26.82% of total corporate deposits (CITIC annual report, 2012).

CITIC Group has numerous financial subsidiaries that engage in multiple business areas including banking, securities, trust fund, insurance, and futures. CITIC Bank has unique competitive advantages via the integrated financial services within CITIC Group. CITIC Bank cooperates with four securities companies under CITIC Group - CITIC Securities, CITIC Securities (Zhejiang), China Securities, and CITIC Wangtong Securities - on third-party depositary services. It is the main depositary bank for CITIC Securities and CITIC Securities (Zhejiang), and the general depositary bank for China Securities

and CITIC Wangtong Securities. At the end of 2012, CITIC Bank shared 4,637 institutional customers with securities companies under CITIC Group, achieving RMB11.35 million fee income for depository services. CITIC Bank shared 4,637 institutional customers, achieving RMB11.35 million fee income. Moreover, CITIC Bank cooperates with CITIC Prudential Insurance to promote insurance services to its customers.

CITIC Bank accepts the importance of customer relationships, and has learnt how to improve services and to develop products for small to medium enterprises, and to provide for individual customers, who have traditionally been taken for granted by state owned banks. On these issues, it learnt from its foreign partners. As with other banks, CITIC Bank divided its clients and customers into four levels: individual customer, VIP customer, small to medium enterprises and corporate clients. For individual retail customers, CITIC Bank focuses on offering multi channel services to improve convenience and efficiency. For individual VIP customers, CITIC bank learnt how to develop wealth management and private banking from BBVA, and to achieve this goal it built an effective cooperative relationship with its foreign partner. As an indication of a growing responsiveness to market demand, CITIC Bank adjusted its entry barriers for different levels of VIP customer services. CITIC Bank focuses on providing services to small enterprises but it is specially noted for its business with tiny enterprises, whose needs have been ignored by state owned banks. For corporate level business, in addition to the design of targeted products, ‘guanxi’ plays an important role. CITIC Bank has the strong capability to integrate its customer and client resource within CITIC Group. For client and customer relationships and product development, the foreign multinational partner has been the significant influence, excepting the corporate level where the CBRC has had a very direct influence. CITIC Bank must follow the percentage of business for small and medium sized enterprises as a total percentage of all business as set by CBRC. The

regulatory authority needs to approve all new products and services, after CITIC Bank's headquarters have designed and proposed them. At the provincial level, the tier one branch can develop a 'short-term' product based on perceived customer requirements that are available for up to six months. However, it still needs permission and approval by its headquarters and the CBRC, which largely reduced the market responsiveness and productivity. Overall, since reform from 2005, CITIC Bank has made significant improvements in the product development and customer service. It has the advantages of sharing clients' resources and designing and selling products within the CITIC Group. As a result, CITIC Bank has the strong capability to integrate customers and services.

8.5 Information and Technology

As Prahalad and Hamel (1990:82), the 'collective learning of the organization, especially how to coordinate diverse production skills and integrate multiple streams of technology', is fundamental. For Teece et al. (1997), dynamic capability refers to the capacity to renew competences in a changing business environment, including periods of rapid technological change. The integration and re-integration of skills, knowledge and technology enable an organization to provide customers with unique services or products. CITIC Bank realizes the importance of information technology development, which largely supports business system innovation, and improves safe operation and risk management control, online banking systems and services, ATM facilities, and mobile services. There are many reasons to operate these services, such as out of hours banking, saving employee time and preventing the need for customers to queue in front of the counter. In 2012, CITIC Bank gave priority to supporting business innovation and management, and to developing IT systems and security. It implemented a group of key projects including the

online financial supermarket, supply chain finance, internal control platform, and wealth management information system, and put them into effective operation. Continuous efforts were made to promote integrated operation and maintenance (OM) management to reinforce internal control. CITIC Bank developed self check for information safety to protect sensitive information.

In recent years, CITIC Bank created different kinds of online service. Mr. Junwei Lei (2013) indicates that Internet banking is one of the most important trends for the development of CITIC Bank. The aims are to support its traditional services, improve service efficiency, and reduce operational costs. With the launch of its online system, CITIC Bank gradually cancelled paper based business application forms, and customers could fill the electronic forms online and sign business contracts by themselves (Mr Junwei Lei, Tier 2 Branch, Electronic Banking Department Vice Manager, interview, 19th July 2013). Customers could transfer money and carry out other traditional services through online and mobile banking. They can pay credit card bills with this service. CITIC Bank developed software or platforms to ensure the effectiveness of online banking services, such as supply chain finance, internal control platforms, wealth management information systems, and risk management. Ever greater innovation of e-commerce products enables the bank to achieve key breakthroughs in online lending and mobile payments, and in B2C e-commerce. In 2012, CITIC Bank had 14,7714 million payments made via e-commerce portals. The Internet Banking Department operates both corporate and personal Internet banking business. In the areas of personal internet banking, CITIC Bank improved their software and operation systems to make it more convenient and safe for customers to use. In terms of corporate internet banking, CITIC Bank not only improved the systems, but also developed a new function of fund supervision, to improve the overall business process, trading risk and system performance. CITIC Bank has many marketing activities to promote its online service and attract new customers, and to enhance the brand reputation. By the end of 2012, the number of

personal Internet banking customers reached 7.5665 million nationwide, an increase of 1.8594 million or 32.58% over 2011. The corporate Internet banking customer reached 127,700, an increase of 30.62% over 2011. In 2012, the number and volume of transactions of personal Internet banking were RMB55.5915 million and RMB3.37 trillion, up by 54.70% and 48.46% over 2011. The number and volume of transactions for corporate internet banking were 17.9340 million and RMB21.28 trillion, up by 33.70% and 22.2% over 2011. In 2012, Internet banking business amounted to RMB 90.4746 million, an increase of 69.80% over 2011 (CITIC annual report, 2012). In terms of personal Internet banking, CITIC Bank developed new functions such as automatic batch pooling of funds, real time FOREX settlement and sales, and subscription for and collection of T-bonds. It released Internet banking software partner v2.0 to support these developments in its Internet banking. In terms of corporate Internet banking, CITIC Bank successfully launched corporate internet banking v.6.5, which features a brand new function of fund supervision over B2B commodity e-commerce, which optimizes business process, trading risk and system performance. As a plus, CITIC Bank organizes a series of marketing activities including 'Win the China Market with Internet Banking' and 'Help Create a Blue Sky'. These initiatives help to acquire new customers, stimulate customer activity and upgrade customer recognition and loyalty.

CITIC Bank focuses on the protection of customer information and safety in online banking. In 2013, CITIC Bank used the online banking certificates issued by an independent third party accreditation authority (the China Financial Certification Authority, or CFCA in abbreviation). This guarantees ID authenticity of the concerned parties and confidentiality and completeness of information in the course of online information transmission, and adopted the mechanism of independent customer information backup to prevent customer information loss caused by system failures (CITIC annual report, 2013). CITIC

Bank formulated the Measures of CITIC Bank for Safety Management of Customer Information, and concluded safety agreements on the use of personal information with employees who had access to customer information. In 2013, CITIC Bank inspected and assessed information the safety of e-banking, tested penetration of internet application systems, and conducted safety self-inspection of important information systems and websites, as well as the control of self-assessment and IT outsourcing risks. In addition, research was intensified to discover new technologies and methods so that the bank can timely prevent the risk of data leakage and improve its system for its prevention.

In 2012, the Customer Service Center of CITIC Bank received 39.26 million incoming calls, including 35.18 million automated phone answering service calls and 4.08 million manual service calls, achieving a 20 second response rate of 85.77%, a customer satisfaction rate of 93.33% and 97.59 % rate for handling customer complaints. CITIC Bank's Customer Service Center made telephone calls to 3.1942 million customers, and proactively marketed all sorts of bank cards and wealth management products. In addition, the Center promoted insurance products to 196,700 customers, driving forward the growth of this business and consequently bringing on higher fee-based incomes (CITIC Bank annual report, 2012).

CITIC Bank made efforts to push forward the mobile banking business. In 2012, personal mobile banking completed basic coverage of all versions of mobile terminals, and released unique functions such as money transfer via a mobile, express account transfer and credit card installments. It progressed functions related to fund and wealth management products. CITIC Bank is the first commercial bank to cooperate with China Mobile, China Unicom, China Telecom and China UnionPay. In 2013, CITIC Bank launched its official Wechat public platform (the most popular mobile application) called 'Mr.

Inquirer' whereby customers could check their credit card balances and payment dates. Customers could inquire or operate account information, available discounts and debt repayment. By the end of 2012, CITIC Bank has 1.2657 personal mobile banking customers in total, 17.53 times that of in 2011. In 2012, its personal mobile banking completed 295,900 transactions, which was worth RMB 1.658 billion in total, 4.36 times and 2.63 times respectively of that in 2011. In 2013, CITIC Bank's personal e-banking business enjoyed rapid development, further replacing traditional channels and playing an increasingly important role in upgrading service efficiency and customer experience. As at the end of 2013, number of customer accounts, traditional account transactions, and internet banking transactions all achieved higher than 30% growth, and personal mobile accounts and transactions achieved 170.11% and 920.39% growth respectively (Mr Junwei Lei, Tier 2 Branch, Electronic Banking Department Vice Manager, interview, 19th July 2013; CITIC Bank annual report, 2013).

8.6 Chapter Summary

Under guidance from the CBRC, CITIC Bank started its reform of products and services, and began the process of improving capabilities. While the case highlights how institutional pressure from the CBRC was the leading source of reform, the alliance with the overseas partner provided a major resource for understanding best practice, devising strategies, and implementation. CBRC sets out a policy framework that it would like to see fulfilled, and all banks understand in what ways they must development capabilities and competitive advantage. In parallel CITIC Bank, with the advantage of its partnership with BBVA, makes a range of product and service proposals to its regulatory body, which grants permission.

To facilitate reform of its capabilities, CITIC Bank's ownership structure changed. It evolved into a shareholding bank, named China CITIC Bank Corporation Limited. As happened to state owned commercial banks, major shareholders include state owned enterprises, private enterprises, and foreign investors, and CITIC Bank must accept responsibility for its own loss of profit by law. Although BBVA could take two seats at the board meeting, it is not allowed to participate in management decisions, in any case regulated and supervised by the CBRC. BBVA had a cooperative agreement with CITIC Bank to help in particular in product development, private banking, and wealth management, which are those areas not as well developed in the Chinese banking industry. Therefore, a small number of personnel from BBVA worked in the relevant departments for these products CITIC Bank headquarters. However, these personnel were advisory and had no management decision-making authority. At the provincial level or below, there are no foreign employees. BBVA has the motivation to expand its business in China by using CITIC' s network. Nonetheless, growth in China for BBVA was limited by restrictions imposed on foreign banks by CBRC and which remained. Another reason was implicit in the nature of banking and the service industries, which are reliant on building client networks and on developing and improving their services in conjunction with or in response to local customers. BBVA has limited chance to interact with local Chinese customers. At CITIC, its involvement was limited to the headquarters. Therefore, BBVA reduced investment in CITIC Bank from 15% to 9% by October 2013. But the influence of BBVA on the development of CITIC Bank, in product development, private banking, and wealth management remains.

The case shows that, as with other banks, provincial level branches have limited authority to make decisions. CITIC Bank headquarters makes the strategic or major management decisions, approved by the CBRC. The

provincial level branch receives guidelines from the headquarters, and implements policies at the city level sub branches. As we have seen, they can introduce temporary products in response to the needs of their local customers, allowing some scope for initiative, although the processes of gaining permission continue to be extensive and lengthy. Overall, the view is that he CBRC strongly controls the management practice of the bank, and centralized management decision making from headquarters leads to the low responses to the market at the branch level. The long term aim is to develop capabilities and initiative at the local level, but for the time being the push for change is top-down.

The case shows that the delivery of products and services relies heavily on the training of staff. CITIC Bank emphasizes the training of its employee, and, after 2011, it provided specific training courses for different staff positions. These specialized courses largely enhanced specific knowledge and skills for each position, and internal promotion procedures have been altered to reflect the training programmes and the bank's declared human resource objectives. Before the introduction of training programmes and examinations, promotion had relied almost entirely on 'guanxi'. Employees under the new procedures need to attend a relevant training programme and pass examinations, and so they must have basic knowledge of their position before selection occurs through network connections. The restructuring of CITIC Bank's human resource management started with the replacement of lifetime employment, as with the other banks, by the direct contract and the outsourcing contract. New employment conditions helped CITIC Bank to improve qualifications and skills, and so enhance efficiency. They were linked to initiatives in training, incentives and promotions. Compared to state owned banks, CITIC Bank prefers recruitment from the local labour market, as against graduate recruitment, and to hire experienced employees, particularly those who have previously worked in state owned banks. It strongly believes that, in the banking sector,

interaction with customers and client networks are strengthened by local connections. The policy explains why CITIC Bank tends to hire employees locally. The use of local employees and the recruitment of experienced candidates help CITIC Bank to enhance its competitive advantage by extending and deepening its client resources. For examples, many of its senior managers previously worked for CCB, and they have brought their clients to CITIC Bank. However, there is an danger that the completive advantage may not be sustained or stable since employees leaving the bank may take their client networks with them. 'Guanxi' still plays an important role in the Chinese banking sector, particularly for the corporate level. For these clients, state owned banks tend to have more competitive advantages than the commercial banks, as the corporates tend to be government bodies, state owned companies, or former state businesses.

The resource-based view of strategy is founded on the idea that the long-term competitiveness of firms is rooted in their effective use of resources and capabilities that are not easily imitated by rivals. Under the aegis of CBRC, therefore, Chinese banks need to differentiate themselves, and build their competitive advantages. One way that CITIC Bank has begun to do this is in its focus on small and medium enterprises, which fits neatly with its preference for local managers, and, in Hunan, it has taken the lead in forging services for 'tiny' scale firms. The bundle of products, services, client networks and especially trained personnel in these dimensions of banking amounts to a distinctive set of capabilities and resources. In addition, in the context of the Chinese market, CITIC Bank has dynamic capabilities in its integration of customers, products and services across the CITIC Group.

The nature of service industry suggests that firms need to prioritize the creation of intangible capabilities in skills or knowledge with which to create locational specific and responsive products or services. Customer demands

and being able to meet them in a timely manner are important in the service, once, as is occurring in China, firms begin to compete. The trend in online and mobile banking shows an attempt to provide more convenience for customers. In 2013, guided by the strategy of offering multi-channel services, that is ‘creating another CITIC Bank online’; the firm has made progress in Internet, mobile and telephone services. In 2013, CITIC Bank particularly improves the protection of customer information and safety in online banking. Mobile banking is considered important by CITIC Bank. In 2012, personal mobile banking service covered all versions of smart phone terminals, allowing customers to log on and see their accounts. In information technology development, as took place in state owned commercial banks, market demand forced the pace of change in service channel, while the experience of the foreign partner can assist implementation. The CBRC has had less influence in technology and Internet service in comparison to internal company initiative and foreign partner advice.

Chapter 9

The Huarong Xiangjiang Bank

9.1 Background

As we have seen (see Chapter 2), the Chinese government established city commercial banks in order to increase competition in the banking sector and to accelerate local economic development. In essence, the policy was to establish better banks for better regions. City commercial banks were established from 1995 onwards, the first example being the Shenzhen City Commercial Bank, and occurred when the reform of Chinese banking entered its third phase (1994-2002). By 2002, city commercial banks had formed strong connections with small and medium enterprises, and with local government, whose own banking requirements but also its networks in the community served as the initial client base for the new businesses. However, they ran up large levels of non-performing loans. They were weakened by corrupt senior management, and by a lack of management capability for further development. Since the establishment of the CBRC, provincial or local government was not involved in the regulation or ownership of the banking sector, but the non-performing loan levels and the weaknesses of management teams worsened. Therefore, the case for reform of these banks became increasingly more compelling.

China Huarong Asset Management Co. Ltd (China Huarong) is one of the big four-asset management firms in China. It is a state-owned financial institution approved by the State Council. China Huarong, founded in October 1999, focuses on banks, trust funds, and leasing businesses, for whom it provides

the management of equity and fixed income portfolios. Its main responsibility is to deal with the non-performing assets of domestic banks. Its headquarters are located in Beijing. China Huarong purchases, manages, and disposes of non-performing assets transferred from Chinese banks (China Huarong, annual report, 2013).

China Huarong was interested in the acquisition and merger of commercial banks because it did not have a license to operate a banking business on its own accord. It wants to extend its activities into small and medium enterprise, and it gains synergies by offering loans and other financial products. City commercial banks, in response to CBRC supervision and reform , need a strategic partner able to provide capital support and professional asset management skills (Mr Wei Xiong, Headquarters, Broad of Supervisors, interview, 25th July 2013). From 2007, China Huarong and a number of key city commercial banks in Hunan began to prepare for restructuring. As the CBRC directly controlled and supervised the big state commercial banks, the Hunan government had no influence over their business decisions, but needed a sizeable provincial bank that could support local economic development and fund public projects. Therefore, Hunan government supported the merger between China Huarong and the local city commercial banks. The CBRC regulated that China Huarong could only take a shareholding in one single firm within the bank sector. China Huarong, the city commercial banks, and the Hunan all supported the creation of a new bank enterprise.

Huarong Xiangjiang Bank Corporation (HXBC) was established in October 2010, through the acquisition and merger of the Zhuzhou City Commercial Bank, Xiangtan City Commercial Bank, Hengyang City Commercial Bank, the Yueyang City Commercial Bank, and the Shaoyang City Credit Union. The

original plan was to include the Changsha City Commercial Bank, the largest of its kind in Hunan, and it decided that it had a future as an independent enterprise. By 2007, it would be China's eighth largest bank of its kind. Having over several years arranged for the reform of the city commercial banks, the CBRC turned its attention other areas of the financial industry. HXBC's headquarters is located in Changsha. In 2010, HXBC had ten Tier 1 city level branches. In 2013, the figure had increased to 13, located in Changsha, Xiangtan, Zhuzhou, Hengyang, Yueyang, Shaoyang, Chengzhou, Changde, Huahuai, Yinyang, Loudi, Yongzhou, and Zhangjiajie, so that only one Tier 1 city in Hunan province is without a branch. The total number of sub branches, which are the operational units dealing with the customer directly, is 139 (HXBC annual report, 2013). HXBC mainly provides services to local small and micro enterprises and individual customers, and it supports local government projects. HXBC aims to create "small, precise, new, special" services, and it is committed to a series of strategic steps, beginning with differentiation, and then market-orientation, diversification, regionalization, and, ultimately, internationalization. In this respect, HXBC's statement of its long term goals is typical of Chinese banks. China Huarong aims to provide strong capital support and professional asset management skills to HXBC, which claims to have largely improved its governance structure, business management practices, risk management, and operating performance of HXBC. The company declares that it will improve in five areas in order to build sustainable competitive advantages: market share; create internal synergies; quality of service, customer satisfaction and loyalty; information technology; and brand recognition (HXBC, 2011).

HXBC formulated a 'five year, three step plan' or development strategy between 2010 and 2015. The first stage was in 2010 - 2011. The main aim of this stage was integrating the services, products, processes, information

system, client resource, and corporate culture of the previous commercial banks in order to achieve consistent standards across the Hunan province. Having dealt with the internal organization, the second stage in 2012- 2013 moved on to expanding the business, improving management structure, and building competitive advantages and core competitiveness. The third stage for 2014-2015 seeks higher brand recognitions and achieving the standard of the national commercial banks. HXBC plans to list on the stock market in 2015, and become a national commercial bank (HXBC, 2011).

In 2011, HXBC was given the '2011 annual best national banking financial services specialty products' award by the CBRC. In 2012, HXBC established a new bill business, investment banking, international business, asset management, financial market department, an electronic banking and bank card department, and it also started to extend its business in China outside of Hunan Province, although these are for the time being representative offices such as the one in Beijing. In 2013, HXBC has been reward with the rating of level 2 for overall performance from the People's Bank, which is the highest rate for all provincial level commercial banks. By the end of 2013, HXBC expanded by operating in 8 provinces (HXBC annual report, 2013). After about three years of development, HXBC is the largest provincial level commercial bank in Hunan province. In the first quarter of 2014, HXBC deposits increased by 24.29% to 22.115 billion yuan, higher than the provincial average;. Bank net profit increased 49.48%. It also holds more loans than any other firms operating in Hunan (HXBC Annual Report, 2013).

9.2 Strategy and Control

HXBC is a shareholding bank. The basic ownership pattern was established in 2010, and, as shown by the data for 2013, it remained intact for three years (as table 9-1):

Table 9-1 Major Shareholders of HXBC (2013)

Name of shareholder	Nature of shareholder	Total number of shares held	Shareholder percentage
China Huarong Asset Management Co. Ltd	Stated-owned	3,141,250,000	50.98%
Hunan, Hengyang City Construction and Investment Co. Ltd	Stated-owned	312,087,500	5.07%
Tianyuan Real Estate Ltd	Domestic non state-owned	227,000,000	3.68%
Hunan Trust, Ltd	Stated-owned	194,431,668	3.16%
Xiangtan City Construction and Investment Ltd	Stated-owned	165,388,372	2.68%
Xinhuang Group: Xiangtan Resource and Technology Ltd	Domestic non state-owned	146,517,768	2.38%
Yueyang State-owned Asset Management Ltd.	Stated-owned	143,950,000	2.34%
Hunan Publishing Investment	Stated-owned	100,000,000	1.62%

Holding Group			
Zhuzhou State Owned Asset Investment Holding Ltd	Stated-owned	100,000,000	1.62%
Jinan Juntuyuan Investment Ltd	Domestic non state-owned	87,500,000	1.42%

(Source from: HXBC annual report, 2013)

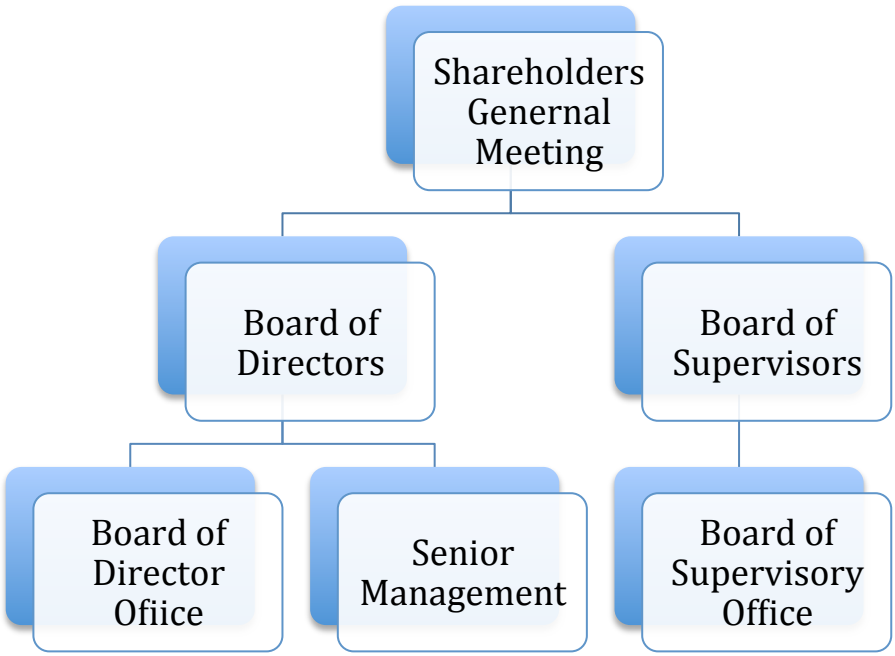
Most of the shareholders are state-owned firms, which are China Huarong Asset Management Co. ltd; Hunan, Hengyang City Construction and Investment Co. ltd; Hunan Trust, ltd; Xiangtan City Construction and Investment ltd; Yueyang State-owned Asset Management ltd; Hunan Publishing Investment Holding Group; Zhuzhou State-owned Asset Investment Holding ltd. The major non state owned domestic shareholders are Tianyuan Real Estate, ltd; Xinhuang Group: Xiangtan Resource and Technology ltd; Jinan Juntuyuan Investment ltd. Eight of these ten firms are in Hunan province. China Huarong has taken the largest ownership of HXBC since 2012. As with the national commercial banks, the Board of Directors retains management responsibility and makes the decisions within the framework set by CBRC. Those Chinese state owned companies and non-state owned companies that invested in HXBC are not expected to exercise control. China Huarong, with 50.98% of the shares, can not directly involve itself in the operation of HXBC, although they can express opinions at the shareholder's general meeting. This situation is similar for all the other shareholders. For the overall improvement in internal management, the appointment of senior manager has become based on performance and examinations, although, as in other cases, they are subject to the final

approval of the CBRC. HXBC headquarters plays the guiding and leading role in market planning, policy guidance, information sharing, championing marketing efforts, technical support, product innovation, resource allocation and personnel training. The management structure, as in Figure 9-1, shows that below the headquarters and its departments are the tier 1 branches at the level of the cities. Each city has its own headquarters, with a human resource department and an information technology function. Within the city, the city headquarters follows the instructions and guidelines of the company headquarters, which is located in Changsha, and manages the sub-branches that deal with customers. Decision-making within the cities is limited, and it is HXBC headquarters that makes the management decisions. The CBRC is charged with setting common standards for all banks, but the provincial commercial banks believe that the CBRC allows the state owned banks to operate in more areas of banking business. For example, the CBRC did not allow HXBC to operate a personal credit card business. The CBRC monitors HXBC's Board of Supervisors, which, as is standard in Chinese bank governance, reports to the shareholders' general meeting. The bank has an organizational structure consisting of the shareholders' general meeting, the Board of Directors, the Board of Supervisors and the senior management (HXBC annual report, 2013). The Board of Directors consists of 12 board members, including 4 executive directors, 5 non-executive directors, and 3 independents. The Board of Supervisors consists of 9 supervisors, including 2 shareholder supervisors, 2 external supervisors and 5 staff supervisors. The senior manager team consists of 11 people. The bank needs to operate and carry out business activities according to the requirements set by the 'Commercial Bank Law of the People's Republic of China', as passed in 1995. From 2012, the CBRC pushed for the transformation of China Huarong and it became a joint stock company aspiring to have a greater commercial emphasis. But, while the China Life Insurance (Group) Company, one of the largest insurance companies in China, has taken a 1.94 per cent of Huarong

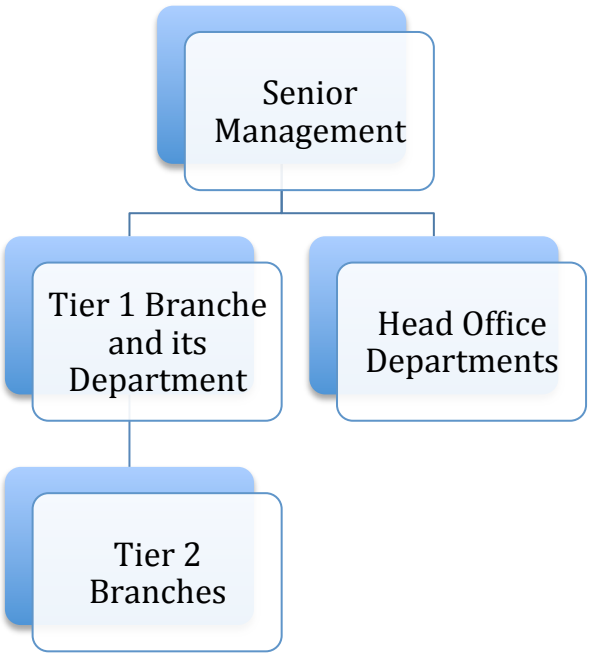
Group share, the Ministry of Finance owns the remaining 98.06 per cent. The joint stock company is the typical means in China for undertaking market listing. China Huarong has in fact floated a number of subsidiaries, such as Huarong Securities, Huarong Trust, Huarong Leasing, Huarong Yufu, Huarong Investment Zhiyuan, Huarong Asset Huiton, and Huarong (Hong Kong) International. Until 2014, China Huarong had 32 branch offices (sub-branches) and 11 subsidiary companies in mainland China, operating in 30 provinces (China Huarong annual report, 2014). The CBRC requires Huarong Group gradually to reduce its shares in HXBC during 2014-2016.

Figure 9-1 Organizational Structure of HXBC

Shareholder's Level



Senior Management Level and Domestic Branches



(Source from: HXBC annual report, 2013)

9.3 Human Resources

9.31 Promotion

When HXBC was founded in 2010, through a merger, it used both the direct contract system and outsourcing. HXBC has labour service agreements with sub-contractors and labour sourcing companies who meet the requests for particular types of employee on a fixed term basis. Priorities were to downsize the number of employees, to integrate and build the new management team, and to create the conditions to improve and change skills. As with other banks, HXBC chose four main ways to achieve the new objectives: all employees had to pass an examination commensurate with their position, or elect for alternative posts or retraining; long standing employees some could opt for early retirement; low skill employees and high skilled personnel such as those

in IT were sub-contracted; and needed staff were hired from other banks (Ms Ping Li, Tier 1 Branch HR Manager, interview, 26th July 2013).

Key senior managers were selected from the original city commercial banks as since existing employees tended to be more familiar with the business and prevailing 'guanxi' relationships. HXBC hired in addition those who had previously worked in state owned banks. City branch presidents or vice presents and headquarters departmental managers or vice manager and other key managers were directly selected and appointed by HRBC headquarters Before formal appointment, HXBC evaluates all candidates with its own written examinations, and all candidates must pass. Normally, and as we have seen in the other banks cases, guanxi is influential in the selection of candidates who pass their examinations.

Before 2010, it is important to note, promotion was almost entirely based on guanxi. Li (2013) states that 'guanxi' plays an important role when recruiting from external labour markets, and a large percentage of senior managers were from other state owned banks in Hunan provinces (Ms Ping Li, Tier 1 Branch HR Manager, interview, 26th July 2013). From 2010, no employee could be promoted without passing an examination, although guanxi was influential in the subsequent interviewing and selection. Other than those directly appointed by the headquarters, the management in each city makes appointments of the key managerial staff at city or below level. Similarly, in these cases, evaluations of the performance of candidates are conducted. Some positions require the candidate to pass the examinations set by the provincial branch, with interviews to follow, but the city level branch could appoint directly in other cases. While most management candidates are found internally, some are recruited from the labour market, or appointed by the CBRC. Each

management level has set job requirements and age limits. Compared to the state-owned enterprises, HXBC is more inclined to waive the age limit restrictions, focusing instead on the performance of employees, because its approach is more commercially inclined (Ms Ping Li, Tier 1 Branch HR Manager, interview, 26th July 2013). Guanxi continues to play a role in the appointment of employees – subject to them first demonstrating the basic knowledge requirements and knowledge – but less so than in many other Chinese banks.

9.32 Recruitment

As in the case of other commercial banks, such as CITIC, there are three types of recruitment: graduate recruitment, open recruitment and internship. Every year, HXBC Bank hires full-time graduates. The process is reflected in other national and provincial banks, as candidates apply online one year ahead of graduation, and the must graduate from a high ranking university. For positions at the headquarters, applicants must have a Master's degree, and be studying from a university officially designated as one of the country's leading institutions. After applying online, candidates attend written examinations, set by HXBC headquarters in papers that include English, administrative and professional skills, knowledge and expertise. After the candidates have passed the examinations, they must attend an interview (Ms Ping Li, Tier 1 Branch HR Manager, interview, 26th July 2013).

Compared to state owned banks, HXBC puts more emphasis on open recruitment, because it seeks to employ people with work experience and client networks. It draws from the local labour market by advertising on company websites or through recruitment agencies. In many cases, and

especially where any future employee will need to work with clients, candidates must have at least three years working experience in the banking sector, two of which must be at the level to which they are being recruited or one level below. Working experience in one of the state owned banks tends to be preferred. An age limitation is set for each position. Liu (2013) states that the age limit for open recruitment is similarly less strictly applied than in the case of other banks. HXBC looks instead at people's client network and experience. Liu indeed indicated that the client network was the most fundamental criteria in hiring managerial personnel (Ms Jun Liu, Sub Branch, VIP and Individual Client Relationship Vice Manager, interview, 25th July 2013).

The internship programme, introduced in 2011, shows that modernizing initiatives had mixed results due to long-standing practices being deeply embedded and difficult to transform. Interested candidates need to apply online, and as a minimum pass a level 6 in the national English test, before being interviewed. Internship experience counts as an additional factor for employment, once a candidate passes the examination in the subsequent year during the formal graduate recruitment process. As in other banks, guanxi and links with important clients explain the reason why most of students were chosen for the internship, with the overriding consideration being what kind of clients the candidate might bring to the bank (Ms Ping Li, Tier 1 Branch HR Manager, interview, 26th July 2013).

9.33 Training and development

Since 2010, HXBC carries out training programmes in its departments. New products or services require the relevant department to conduct training.

HXBC frequently updates and provides information and training materials. New employees will undergo induction training. In 2013, HXBC provided 2,560 training sessions for recruits (HXBC annual report, 2013). The firm emphasizes the 'customer focus' concept in their training for all employees, even for those sub-contracted, such as cleaners. For example, they are asked to greet customers when they walk into the branch, and to provide assistance if they need (Ms Jun Liu, Sub Branch, VIP and Individual Client Relationship Vice Manager, interview, 25th July 2013). On-the job training is designed to improve employees' specialized and general knowledge.

9.34 Pay policy and welfare

As with other banks, HXBC's pay structure is determined by seniority or length of service, job grade, and a performance related bonus. The basic salary and seniority related pay accounts for the smaller part of remuneration. The performance related element, introduced in 2010 to improve personal performance, is consequently more important. Employees enjoy several benefits, such as house purchase, hospital and childcare allowances, plus a child education scholarship. Both the medical and pension allowances are linked with the national medical and pension system, part of a pattern in the banking sector (HXBC social responsibility report, 2013).

9.35 Summary

The employment contract was introduced in 2010 to replace the system of guaranteed lifetime employment. As in the case of the other banks, HXBC has two types of contract. Since it introduced the new system, HXBC reduced the number of employees and selected qualified employees on the basis of examinations. A particular issue for HXBC was that the new bank was a

merger of previous city commercial banks, and, as a result, it had employees undertaking the same tasks. It would need to subject many of these affected employees to demotion. For those unable to pass the examination that was introduced, and if further training was not suitable, retirement or dismissal were real possibilities. Downsizing helped to create the conditions to enhance and change skills. HXBC tends to recruit employees with working experience and in particular to hire senior managers from other banks, as they tend to bring clients based on their personal network. Yet some senior employees quit and joined other banks, taking many of their clients with them. However, staff turnover is not overall a major difficulty, given the firm 's stable employment, substantial welfare arrangements, and competitive pay rates. 'Guanxi' – in the sense of client networks - plays therefore an important role in any individual's career progress. What has changed in a significant way is the introduction of examinations in 2010, ensuring a level of capability, even if selection occurs on another basis subsequently. After the restructuring, by the end of 2013, HXBC has 3,169 employees in total. Of these, 276 or 8.7 per cent had a Master's degree or above; 1,655 or 39.1 per cent had the Bachelor degree (HXBC annual report, 2013).

HXBC provides training programmes for different positions and levels, and training enhances both general and specific knowledge. In its training, HXBC emphasizes 'customer service' in order to maintain commercial relationships. The previous SOE system within the city commercial banks lacked monetary incentives to improve performance. HXBC focused on performance related pay to incentivize employees. Yet it is influenced too by 'guanxi' in the areas of recruitment and promotion. The positive side is that such personal networks can bring clients to the bank; however, such 'guanxi' based clients will follow a manager who leaves the company. Inherited from the SOEs system, the age limitation for certain positions is still a boundary, and removes the motivation of

senior employees not able to be promoted, although HXBC applies the rule less exactingly than competitors. The CBRC has directly influenced the terms of the promotion and the appointment of senior managers, and their recruitment, payment, welfare benefits, and labour contracts, but has not issued directions on training and development.

9.4 Client and Customer Relationships and Product Development

HXBC generally divides its clients or customers into four types, categorized by corporate, small to micro firm, individual VIP customer, and individual customer. Its first, corporate clients, is less important to its commercial operations than the other three, and so its profile is different to the other state-owned banks. To attract and keep the relationships with small and micro firms, both 'guanxi' and service quality can be pivotal. Nonetheless, because of the support from and connections with local government, HXBC has large number of institutional clients throughout Hunan, including public hospitals and television companies. These are supervised by its corporate department. According to Guo (2013) HXBC tends to hire young employees whose parents work as leader of those institutional organizations (Ms Jing Guo, Tier 1 Branch Vice Present, interview, 25th July 2013). For large and important clients, product development is influenced by customer requirements. The local branch passes on customer feedback and requirements to the headquarters, responsible for the design of any product. As we have noted elsewhere, the development of services and products for VIP customers has become an important trend for Chinese domestic banks, and HXBC seeks to improve customer service as well as products for individual customers. It particularly focuses on the training of employees to provide good customer service. In

addition, HXBC introduces clients to the asset management service and the overseas loans and finance services provided by Huarong Group.

HXBC is a provincial level commercial bank, but it has less authority to operate in every sector of the banking business, unlike the state owned banks and national commercial banks. Therefore, their product development tends to be limited by the CBRC, which so far has not permitted HXBC to operate a personal credit card business. The bank does offer a company credit card, but only since December 2012. HXBC has made three-year product development plan, and decided to set up an electronic and card department in each city sub-branch. By June 2014, HXBC had acquired 25,206 business card clients 25206 in total. The business credit card must be opened with the name of company client, yet it is used mainly by employees of each company for personal expenditure. Guo (2013) acknowledges the restrictions placed on HXBC by the CBRC, but the bank operates the business card flexibly because of the size of the personal credit market (Ms Jing Guo, Tier 1 Branch Vice Present, interview, 25th July 2013). HXBC implements the 'customer focus' business concept in its retail banking business. The bank made efforts to promote the retail business through price competition and product improvement. As the same as other banks, HXBC invested in the appeal, look and structure of its sub-branches, of which it has forty-nine. It concentrated on expanding its self-service facilities, including ATMs, minimizing waiting times and improving operational efficiency.

HXBC is developing wealth management for its VIP customers. It has divided them into three levels. The first is for customers who have savings over 300,000 RMB. The second level is for those with over 300,000 RMB, or those with loans from HXBC over 800,000 RMB. The third level is for customers who

have savings over 1,000,000 RMB, or have loans over 2,000,000 RMB. Different services and products are designed for each level. HXBC established VIP Wealth Management Centres at selected branches to provide professional consulting and investment advisory services. Again, most customers are found through "guanxi' (Ms Jun Liu, Sub Branch, VIP and Individual Client Relationship Vice Manager, interview, 25th July 2013; HXBC annual report, 2013).

The development of small and micro enterprise business was given prominence. HXBC adheres to the 'small, tailored, and new special" service orientation to create 'the best partners for SME'. Since 2012, HXBC specially established the micro enterprise department, aiming to provide a quick efficient service. Normally, like other state banks or national commercial banks, small and micro enterprise clients are managed within the same department. In the meantime, to support its initiatives, HXBC established a risk management team and credit approval officers, seeking to shorten decision making processes, and offering a three days fast loan service (previously seven days). In 2013, the CBRC designated HXBC as an excellent small micro-enterprise financial provider. Guanxi has an important role in attracting this group of clients. Many small to micro enterprises senior managers were recruited from other banks because they already had good relationships with certain enterprises, and could bring a large number of clients with them (Mr Wei Xiong, Headquarters, Broad of Supervisors, interview 25th July 2013). HXBC provides banking, financial leasing, trust, equity investments, bond issuance, listing and other financial services to its small to micro clients.

The CBRC regulates the percentage of each type of banking business every firm must achieve. For HXBC, it is not a problem to achieve the target for the

small and medium enterprise, as this is one of them main businesses. The CBRC has limited HXBC's product development. Because HXBC is a province level bank, its business and products can only operate in designated areas. HXBC headquarters develops products within the remit of CBRC regulations and with its approval. The city level branch has no authority to develop products and concentrates on reporting customer feedback to the headquarters. HXBC based on 'guanxi' to bring and maintain customer and client relationships is one of its competitive advantages in Hunan province. However, it cannot be considered a sustainable competitive advantage, as clients who brought by 'guanxi' can be easily lost through 'guanxi' when managers leave for another business. In the area of individual customers, HXBC has the competitive advantage of providing efficient and fast services. But it has a potential disadvantage in its processes for evaluating customers, which might result in non-performing loans. Also, due to the limitations imposed on its products and services by the CBRC, HXBC always 'adjusts' its strategy, as in its use of business credit cards for what is essentially a personal credit card market.

9.5 Information Technology

HXBC claims that it supports business system innovation; the improvement of risk management control; online and mobile banking systems and services; and self-service systems and ATM facilities. They serve customers outside of office hours, reduce waiting terms at counters, and boost efficiency. Since 2011, HXBC has developed different kinds of online service. Dong (2013) indicates that online banking is key to the bank's strategic development, and new technology is being used to support traditional services through product innovation, the expansion of service capacity, greater efficiency, and lower operational costs (Mr Zhiqiang Dong, Tier 1 Branch, Electronic

Department Banking Vice Manager, interview, 26th July 2013). With the launch of the online system, the bank gradually cancelled paper application forms, and customers could fill forms online and sign business contracts. Customers now have the choice to transfer money electronically although some operational and technical difficulties remain. HXBC has created a separate Internet Banking Department for corporate clients and another for its personal service. HXBC has enhanced its multiple-channel customer service. In the area of personal Internet banking, HXBC improved its software and operational systems to increase convenience and security. In terms of corporate Internet banking, HXBC has developed an online system for supervising funds and tracking business activities. HXBC runs a series of marketing activities to promote its online service, win new customers, and maximize brand reputation.

HXBC started its mobile banking business since August 2013 to enhance the multiple-channel customer service. Most smart phones can log in to their mobile banking. HXBC also has developed telephone banking, and it has a special line for VIP customers. Telephone banking operates 24 hours, and its services include lost and stolen reports, service advisors, transfer, and pin number changes. In addition, HXBC reached agreement with its institution clients, so that customers can check and transfer their social insurance payments and pensions through HXBC within Hunan province (HXBC annual report, 2013; Mr Zhiqiang Dong, Tier 1 Branch, Electronic Department Banking Vice Manager, interview, 26th July 2013).

In the area of information technology, in its effect on service channels, market demand has been instrumental. HXBC has prioritized online banking, mobile and telephone banking, multiple channels, and quick and convenient service.

The building of the information and operational system was sub-contracted. The problem remains in the updating of its systems and when there are technical problems. Compared to the big national commercial banks, HXBC lacks the help of foreign strategic partners. Therefore, HXBC does not have strong competitive advantage in IT.

9.6 Chapter Summary

Under the supervision of the CBRC, many local commercial banks lost the protection of local government, and their weaknesses including non-performing loans were more fully exposed. The CBRC forced the reform of local commercial banks following their initiatives with the big four banks and the national commercial banks. City commercials banks began a series of changes. They should have strong capital support and asset management skills. Huarong Group is one of the big four-asset management companies in China. Huarong Group is a state agency charged with clearing bad loans in banking and providing asset management. Therefore, since 2007, China Huarong and those city commercial banks begin to prepare for merger. Firstly, the city commercial banks needed the capital and management skills support of China Huarong. Secondly, China Huarong wanted to operate its own banking business through the network controlled by the city commercial banks. Thirdly, Hunan government desired a strong and capable provincial bank, which could support local economic development and government projects. It consequently supported the acquisition of city commercial banks by Huarong. Therefore, Huarong Xiangjiang Bank Corporation Limited was established in 2010 with its headquarters located in Changsha.

The case demonstrates that the CBRC has been the leading force for reform. It insisted on the reform of the city commercial banks, and Huarong initiated the acquisition and the merger as the solution to the policy aim. The merger allowed strong financial support and formed a resource for best practice. In terms of providing new products and services, customer and market demand as well as institutional factors have been influential. With the merger, HXBC is a shareholding bank. The bank's major shareholders include state owned and private enterprises. The majority of those top ten shareholders are from Hunan province. HXBC has been made formally responsible for its profits and losses. The headquarters makes the majority of management decisions, and the authority of the tier 1 city level branch is limited.

Since 2010, the labour contract system-assisted downsizing, and created the conditions to improve, integrate and change skills. 'Guanxi' remains in promotions and in recruitment. The introduction of examinations during promotion and recruitment ensures basic knowledge for any position. HXBC imposes an age limitation for promotion and recruitment, as do other banks, but it is less strict in its application than its rivals, leaning to a greater extent on personal performance. Performance related pay is more common since employment reform, and HXBC has begun to provide different training for each department and employee grade since 2010. The HXBC case shows that methods of knowledge transfer rely heavily on the training of staff. Training programmes enhance both the general and specific knowledge. One of the strengths of HXBC is its focus on 'customer service' training, so that even their sub contracted employees such as cleaners must also attend customer service training. The CBRC has directly shaped promotion policies, and it has to approve appointment to senior level. It has indirectly influenced recruitment, as it needs to approve examination papers.

As a provincial level commercial bank, under CBRC regulation, HXBC could not operate business in all sectors as other national commercial banks. In the sectors in which it is allowed to operate, HXBC emphasizes customer relationships, small to micro enterprises, individual VIP customers, and retail business. State owned banks have traditionally overlooked the small and micro firms. HXBC relies on previous client and customer relationships, and has strong competitive advantages within Hunan province and its networks, in its target sectors. HXBC has significant support from the local government in terms of policy, resources, projects and institutional clients. It has proved better at interpreting customer feedback from the branches for the consideration of the headquarters in comparison to the state owned banks and the national commercial banks, providing some source of competitive advantage. HXBC as a provincial level bank has fewer layers of management, and the result is a higher measure of operational effectiveness than its national rivals. It has introduced professional and technical personnel to improve technological competence and innovation, shown in its use of IT and online services.

Chapter 10 Comparisons and Conclusion

This chapter compares five Chinese banking cases, the continuous differentiation and hybridization of practices, and the strong influences of government and domestic institutions, FDI, and firm-level agency, in the development of human resources, client and customer relationships, product development, and informational technology.

10.1 Background

China's decision to begin the process of economic reform in 1978 brought about the first steps in the change of the banking system. Until 1984, the main task was separating the People's Bank of China (PBC) from its involvement in commercial banking and banks. It began therefore to focus on its role as regulator and supervisory central banker, and four state owned banks in 1984 took over the commercial activities of the PBC. The Bank of China (BOC), originally established in 1912, had a tradition and experience with foreign exchange and trade finance. Therefore, in 1979, BOC had formally taken over PBC's business in trade and foreign currency transactions, although the practice differed from the reality of PBC's continued involvement. The China Construction Bank was established in 1954. As it main responsibility was supporting, providing and allocating the funds to government construction and infrastructure projects, the China Construction Bank in 1979 took over the main responsibility for providing funding for the government and urban large construction projects. The Agricultural Bank of China, which was founded in 1951, had taken over main responsibility for providing funds for farming and rural areas. In 1984, the Chinese government established the Industrial and Commercial Bank of China to be mainly responsible for commercial banking

activities in urban areas. By 1984, the first stage of reform's main task had almost achieved, and the PBC did not have commercial bank functions, concentrating as a central bank on monetary policy, financial markets, and the issuing of bank notes. The four specialized state owned commercial banks operated in their designated sectors, base, and there was no competition at this stage in the banking sector.

The second period of reform occurred between 1984 and 1994. The chief task was to remove the restrictions on the four specialized state owned commercial banks, allowing them to operate commercial and retail service in all sectors. The main aim was moving from a wholly policy-driven banking system to a more market-oriented one. These four state owned banks could cross business sectors but they were still very much government controlled. In order to bring further competition, the Chinese government allowed the commercial banks to provide services to individuals and to small and medium sized urban firms. CITIC Bank, established in 1987, was a pilot for the commercial bank sector. Other national commercial banks included the Bank of Communications, the Shenzhen Bank, Guangdong Development Bank, China Merchants Bank, China Everbright Bank and Hua Xia Bank. The Chinese government allowed urban credit cooperatives in order to diversify banking services to individuals, small to medium firms, and rural areas. Although, since the mid of 1980s, the government removed restrictions for the four specialized state owned commercial banks, they were still focusing on the industry in which they were specialized. Due to rapid economic development in China, the large amount of urban development, and government projects, the Industrial and Commercial Bank became the leading bank, by 1993. During this time, domestic banks still needed to conduct lending decisions based on the needs of the national economy and social development, following the direction of the

state's industrial policy. The policy led to a huge amount of non-performing loans as the result of lending to SOEs.

After the 14th National Congress, in November 1993, the State Council issued the Resolution on Financial System Reform. Then, entering the third period of banking reform, from 1994 to 2001, the main tasks were further removing the restriction on state-owned specialized banks, permitting them to operate business across sectors, and encouraging competition among banks. The main objective was transforming banks into market functioning and profitable organizations. Therefore, in 1994, the Chinese government established three policy banks to take over long-term development finance and policy lending as previously performed by the four state owned banks. In 1995, the Commercial Bank Law of China officially confirmed PBC as the central bank, and made the major state-owned banks into shareholding banks. The Law regulated that banks needed to responsible for their profit and losses. In order to further increase competitions, the Chinese government allowed the establishment of city level commercial banks. The establishment of three policy banks, with the aim of reducing the impact on banks' credit allocation decisions, sought to enhance the independence of the commercial banks, but local government still invented in the local commercial banks' credit allocation decisions. The support from local government and the 'guanxi' based local network had helped the quick growth of local commercial banks during the late 1990s. In the meantime, the major clients of state owned banks were still SOEs, and the state owned banks still had significant non-performing loans. The Chinese government kept writing off and cleaning up their deteriorated balance sheets. Therefore, on the one hand, the local commercial banks had support from local government; and the state owned banks still had help from central government; domestic banks still had less incentive to compete with each other, and the

Chinese banking sector was still marked by bureaucracy, inefficiency, and out-dated practices.

In 2002, China joined the WTO, and committed itself to opening up the financial and banking sector. However, the Chinese banks suffered from high levels of non-performing loans, and lacked the competitive advantages needed to face global competition. Under these circumstances, in order to protect, regulate and accelerate the development of the Chinese bank sector, in 2003, the Chinese government established the China Banking Regulatory Commission (CBRC) to oversee reform. The banking sector reform entered the critical fourth phase of development. Following the rise of greater local and international competition, and WTO accession, Chinese banks needed to evolve their own strategies, capabilities and systems. The CBRC selected CCB and BOC to be the pilots for its policy of creating more market oriented and profit conscious commercial banks. The lessons learnt from CCB and BOC were used to transform other banks. Following these initiatives, ICBC started reform in 2005. In the meantime, national commercial banks started to change from 2005. For example, CITIC Bank began its restructuring in 2005. Then the next wave of restructuring was the city level commercial banks. The Hunan province city level local commercial banks, including Zhuzhou, Xiangtan, Hengyang City and Yueyang City Commercial Banks, and the Shaoyang City Credit Union were put the management of the China Huarong Asset Management Corporation, and restructured and merged as the Huarong Xiangjiang Bank in 2010. It showed how institutions were the leading force for each stage of Chinese bank reform.

10.2 Strategic Control

Under the newly appointed CBRC, in 2003, with the clear aim of creating a commercially orientated structure, Chinese banks started restructuring as shareholding banks. The first wave was the two pilot banks: BOC and CCB, which both started restructuring in 2003, and becoming joint stock, limited companies in 2004. Then the second wave was the other state owned bank, ICBC, and the national commercial banks. Both ICBC and CITIC Bank became joint stock limited companies in 2005. Interesting the Agricultural Bank began its change process in 2004, finishing 2009, and transformed to a joint stock structure in 2010. In 2005, at the requirement of the CBRC, and with aim of further evolving into a commercial bank, CCB was the first Chinese bank listed on the Hong Kong Stock Exchange market. In 2006, also under the requirement of the CBRC, BOC listed on the Hong Kong Stock Exchange and the Shanghai Stock Exchange, and was the first Chinese commercial bank to launch an A-Share and H-Share initial public offering and achieve a dual listing in both markets. At the same year, ICBC listed in both Hong Kong and the Shanghai Stock exchange market. One year later, in 2007, CCB floated on the Shanghai Stock Exchange market. Then the next wave was the restructuring of city commercial banks. By the end of 2007, the four banks of CCB, BOC, ICBC and CITIC had all listed on both Hong Kong and Shanghai Stock Exchange market. At that time, within the top 10 shareholders, they had both state owned enterprises, non-state owned domestic enterprises, and foreign investors.

By 2013, most of the main shareholders had remained intact for seven or five years. For the three state owned banks - CCB, BOC, ICBC - their main shareholders were Huijin and HKSCC. Huijin took over 50% of the shares in CCB and BOC, and over 35% in ICBC. Huijin is the Central Huijin Investment

Ltd, which was founded in December 2003, and is headquartered in Beijing. Central Huijin is a state owned company, and mandated to exercise the rights and the obligations as an investor in major state-owned financial enterprises, on behalf of the State. Although those banks moved towards being commercial oriented banks, the State still exercises a large share of control through Huijin. The cases indeed show the decline of the shares from foreign investors. The CBRC encourages Chinese domestic banks to cooperate with foreign banks. In the meantime, in order to protect ownership and control, it firstly regulated that foreign investors could have no more than 15% of shares in any bank. It secondly regulated that foreign investors could not be involved in management decision-making. The cases findings indicate that the most significant changes occurred in foreign investors' shares. In 2007, the Bank of America was amongst the top 10 shareholders in CCB, with its share being 8.19%, but, in 2013, the share was only 0.8%. RBC China Investment was among the top 10 shareholders in BOC, having 8.19%. However, in 2013, the share was 8.25%, and it was no longer one of the top 10 shareholders in BOC. Similarly, Goldman Sachs and American Express were the top 10 shareholders in ICBC in 2007, but no longer so in 2013. HXBC was established in 2010, and, since then, until 2013, the China Huarong held over 50% of its shares, the rest being held by the state or domestic non-state owned firms, meaning that there are no foreign investors.

Despite changes in ownership structure, Chinese banks maintained management control. The Board of Directors of each bank retained the greater responsibility for management decision-making, within the policy framework and subsequent approval provided by the CBRC. Shareholders are not expected to exercise control over the operations of those banks, and they are unable to determine management decision making, even if they give opinions at the shareholder's general meeting, and offer broad supervision and

corporate governance. One consequence of the change in ownership and objectives has been an overall improvement in internal management, with the appointment of senior manager being based on performance and examinations, subject to the final approval of the CRBC.

The three state owned banks and the national commercial bank, CITIC Bank, have similar management structures. Normally, below the headquarters and its department are the branches at the level of the provinces, the autonomous regions of Hong Kong and Macau, municipalities such as Beijing and Shanghai, and special listed cities such as Shenzhen, all being defined by officially determined structures. There are in addition the Overseas Branches and Representative Offices. Within the provinces, there is a provincial level headquarters, which acts as the means for implementing policy at the level of the City or Country sub-branches that deal with customers. The municipalities act similarly by carrying out the directives down towards the operational level of the Urban District, just as Special Listed Cities and autonomous regions have parallel sub-branches. Decision making within the provinces- as in the case of the autonomous regions, municipalities and special listed cities - is limited. Each bank headquarters makes the management decisions with the approval of the CBRC. The provincial, municipal and listed city branches have specialized departments at their headquarters, including human resources, information technology and credit cards, in order to coordinate with the main office, help with policy implementation at the sub-branches, and manage corporate clients. HXBC is a provincial level commercial bank, but its management structure is similar to those national commercial ones, excepting the fact that its headquarters inevitably operates at the provincial level. Below its headquarters and its departments are the Tier 1 branches at the level of the cities. Again, each city has its human resource and information technology function. Within the city, the city headquarters follows the instructions and

guidelines set by the company headquarters, and acts as the means for implementing policy at the level of the sub-branches that deal with customers. Decision-making within the cities is limited, and it is the HXBC headquarters that makes the management decisions with approval of CBRC. All those cases indicate that Chinese banks implemented similar management structures. Each bank headquarters made the management decisions, with the approval by the CBRC. The CBRC has the same regulations for all banks. The state owned banks cases indicate that the CBRC exercises more strict supervision compared to non-state owned banks. On the other side, the commercial banks believe that the CBRC provides more monopoly business for the state owned banks. What is apparent is that the CBRC as the regulatory institution is the formative influence on the ownership, governance and management structures of Chinese banks.

All banks have established and improved their organizational structures for corporate governance, consisting of the Shareholders' General Meeting, the Board of Directors, the Board of Supervisors, and senior management. The Board of Directors makes the strategic decisions of the Bank. The senior management is the executive body of the Bank accountable to the Board of Directors. Each bank has a strict division of duties and separation of power between the Board of Directors and senior management. The senior management operates the business based on the decisions made from the Board of Directors. The Board of Supervisors takes the responsibilities of supervising the operations of the bank, and it is accountable to the Shareholder's General Meeting.

Table 10-1: Development of Resources and Capabilities: Strategy and Ownership

	2003	**2013**
Ownership control	Central or provincial government control	Indirect government control through state owned investment firms such as Huijin Minority private and foreign ownership
Decision-making	Company headquarters makes management and product decisions, but central or provincial governments intervene in decision-making	Company headquarters makes management decisions with approval of CBRC
Listing Status	Wholly state owned	CCB, BOC, ICBC and CITIC listed on both Hong Kong Stock Exchange and Shanghai Stock Exchange HXBC not listed on any stock market

FDI facilitated the development of manufacturing in China, such as automobiles, electronics, and clothing sectors. In order to further enhance the competitive advantages of domestic banks, the CBRC encouraged Chinese banks to cooperate with foreign banks. Chinese banks sought strategic alliances with foreign multinational investors with the aim of learning management skills and global 'best practice'. In 2005, the China Construction Bank Corporation (CCB) signed a five years cooperation agreement with the Bank of America. In the same year, the Bank of China (BOC) allied with Royal Bank of Scotland and UBS AG. In 2006, CITIC Bank established a strategic alliance with the Banco Bilbao Vizcaya Argetaria S.A (BBVA). In the same year,

the Industrial and Commercial Bank of China Limited signed an agreement with Goldman Sachs, Allianz and American Express. Chinese banks looked to improve its managerial skills, human resources, information technology, and product development, and its understanding of the consequences of being listed on the stock market. Foreign MNEs wanted to expand their business in China by using the networks of domestic banks. Different banks choose their partners based on different requirements. CCB, BOC CITIC chose commercial banks which are mainly focused on corporate and consumer banking and on wealth management as their partners. Therefore, those partners could help Chinese banks in many areas of commercial banking business. ICBC chose finance companies which were mainly focused on specific finance markets: ICBC chose American Express to help improve its credit card business; Allianz to help improve its insurance business.

The cases findings in this research show that the motive for FDI was the transfer of know-how, and the impact on ownership and management control was minimal and falling. Foreign partners were rarely involved in their decision-making. The case findings show that the means of foreign partners being involving in the business were different. Some foreign managers could be in the board member position. Some foreign personnel could work in selected departments of the banks' headquarters. But they had no management responsibility in any of the cases. For example, CCB allowed one member from the Bank of America to the board of directors, although that person has no management responsibility, and that member could give opinions in the shareholders meeting. About 50 personnel from the Bank of America at one point worked in CCB's departments such as risk management, governance, and consumer banking. Similarly, CITIC Bank allowed two representatives from BBVA to attend the Board of Directors, again without any management responsibility, and they could give opinions in the shareholders

meeting. ICBC allowed one member from Goldman Sachs to attend its Board Directors, again without any management responsibility, and as in other cases with the right to speak at shareholders meeting. However, ICBC did not allow Allianz and American Express representatives, who helped its development of particular business areas, to attend the Board Directors. BOC allowed one representative from RSB to attend the Board of Directors, but not USB AG. The case findings show that the different level of foreign partner involvement in Chinese banks might impact their approach to extending their strategy agreement. CCB and the Bank of America extended their cooperative agreement in 2011, lasting to 2016. The Bank of America had personnel in CCB, and both parties achieved their targets through their cooperation. Similarly, CITIC Bank and BBVA extended their cooperative agreement. Nonetheless, BBVA shares in CITIC Bank slightly decreased from 15% to 9.9%, even if BBVA remains listed amongst the top 10 shareholders in CITIC. On the opposite scale, BOC and ICBC's foreign partners were less involved in their management. Those parties did not achieve what they want through cooperation. Therefore, RSB and USB AG gradually sold out their shares in BOC. Similarly, Goldman Sachs, Allianz and American Express gradually sold out their shares in ICBC. The cases indicate that there have never been any foreign managers involved in banking operations in Hunan province or at the any operational level. While the potential for cross-border alliances could be beneficial for headquarters development, the evidence suggests that multinationals have established relations as investors with the headquarters of China's large banks, but that the CBRC regulations have limited the levels of investment.

Table 10-2: Development of Resources and Capabilities: Foreign Direct Investment

	CCB	**BOC**	**ICBC**	**CITIC Bank**	**HXBC**
Listing Status	Listed on Hong Kong Stock Exchange in 2005 and Shanghai Stock Exchange market in 2007	Listed on Hong Kong Stock Exchange and Shanghai Stock Exchange in 2006	Listed on Hong Kong Stock Exchange and Shanghai Stock Exchange market in 2006	Listed on Hong Kong Stock Exchange and Shanghai Stock Exchange in 2007	Not listed on any stock exchange
Major Foreign Investors	Bank of America	Royal Bank of Scotland UBS AG Temasek	American Express Allianz Goldman Sachs	BBVA	No foreign investor
Influence of investor on management practice and products	Corporate governance, risk management, consumer banking, wealth and private banking	RBS: wealth management, credit cards, corporate banking UBS: investment banking and securities	Amex: credit cards Allianz: insurance Goldman Sachs: risk management, and corporate and investment banking	Human resource management, information technology, product development, private banking, and car financing	N/A

Cooperative agreement (2013)	Renewed cooperative agreement	Ended strategic alliance	Ended strategic alliance with Amex and Allianz, but still cooperates with Amex in credit card	Renewed cooperative agreement	N/A

10.3 Human Resource

Highly skilled employees are a key resource in the banking sector for creating new products and strengthening client relationships. Personal contact and interaction are important to the development of networks and client relationships. The CBRC guides Chinese banks in developing 'best practice' human resource management, and combines overseas and established domestic systems. One important sign of CRBC's intention to transform the industry was the change in employment contracts, as introduced in 2003. Under the stipulations of the Labour Law and Labour Contract Law, there are two types of contract that replaced lifetime employment; the direct contract system and the outsourcing system. All five banks used both types of contract. As well as employing staff directly on a permanent basis, the new contract system helped the banks to select suitable candidates, and to reduce redundant employees. Furthermore, the banks have labour service agreements with sub-contractors and labour sourcing companies, which meet requests for particular types of employee on a fixed term basis.

10.31 Promotion

The cases show there are similarities and differences in human resource practices amongst the five cases. The former state owned banks tend to promote mostly managerial staff internally rather than recruiting from the external labour market. Normally, managerial staff are directly selected and appointed by the headquarters. Internal selection has a rationale, as employees tend to be more familiar with the bank and its business. Moreover, the iron rice-bowl approach of the SOE system still influences recruitment and determines internal selection, because of the effects of lifetime employment. The banks never directly owned by the state tend to promote managerial staff internally, but they will hire people from the external labour market since they can bring their clients with them. For example, the case of CITIC Bank shows that, in Hunan province, most senior managers were recruited from CCB. In all the five cases, before formal appointment, all candidates need to pass written exams set by the bank's headquarters and approved by the CBRC. Normally, at that point, the candidate is selected due to strong political or organizational support. Most of them are members of Communist Party of China, although the claim is that there is no connection between promotion and membership of the Party. Performance during the past years must also be evaluated, and interviews will be held. Personal relations with high-level officials are still important elements in promotion after the passing of exams. Other than those directly appointed by the headquarters, low-level managerial staff are appointed at province or city level. Their performance during past years is likewise evaluated. Some positions are linked to passing examinations set by the banks at the provincial branch and subsequent interviews. While employees are likely to be promoted on the basis of personal networks, they must first demonstrate that they have reached the basic knowledge requirements for the position. Appointments retain age maximums, but the

non-state owned banks such as CITIC and HXBC tend to less strict on the age limit and focus more on performance.

10.32 Recruitment

In all cases, banks have three types of recruitment in common, which are graduate recruitment, open or agency recruitment, and internship. For the state owned banks, they have targeted recruitment as an additional method, although graduate recruitment is the main means. Every year, they hire graduates from the university, with online application being open one year ahead. The CBRC regulates that all that all those hired must graduate in the same year. The banks prefer students that have participated in social activities or as leaders of the student union, but no work experience is required. The candidates need to finish applications through an online registration system, and next sit examinations at the bank headquarters. Targeted recruitment is similar to graduate recruitment. For state owned banks, every year, there is limited space for targeted recruitment, for which the grades or university ranking are less strict. This recruitment is more likely to open the door for graduates who did not reach the standard of graduate recruitment but have strong “guanxi” or are the children of employees. Agency recruitment gives opportunities to the local labour market, with jobs being advertised through the company website and employment agencies. It follows the same process as the graduate programmes. Non state owned banks tend to provide more opportunities for agency recruitment. All banks have an internship programme, which provides opportunities for the student who will graduate in the following year to learn about aspects of banking. For state owned banks, they prefer to hire fresh graduates, and their recruitment policies favour well-educated young people with a high level of commitment. The commercial, with more chances for open or agency recruitment, seek employees with working experience.

10.33 Training and development

Due to the bank industry's demand for more skilled workers, banks need to provide training, which the CBRC encourages. The case findings reveal how all of the cases have focused on training and development since 2003. The evidence shows that the state owned banks - CCB, BOC and ICBC - tend to focus their training efforts at the managerial level, and selects managers for training opportunities overseas. The commercial banks - CITIC and HXBC - tend to focus on the training for customer services, and emphasize the concept of service. In particular, HXBC emphasizes the 'customer focus' concept in their training for each level of employee. Even sub-contracted employees such as cleaners receive 'customer service training'.

10.34 Pay policy and welfare

The case findings show that all banks have the basic welfare provision based on relevant national or local government regulations, plus additional systems. Pay is based on the basic salary, performance related pay, and position and seniority pay. In the previous SOE system, employees enjoyed many benefits such as the house purchase allowance, hospital allowance, childcare allowance, and child education scholarship. After the SOE reform, the hospital allowance or pensions, for example, are linked to general medical and pension systems, in accordance with the revised legal requirements. All banks have participated in local social insurance schemes to provide basic pensions, healthcare, unemployment cover, industrial injury cover, and maternity benefits, and they have in addition set up a housing provident fund for its staff. The introduction of the performance related pay system is intended as an incentive and as device for raising productivity.

10.35 Summary

The CBRC has directly influenced the promotion and appointment of senior managers. It has less directly influenced recruitment, pay, welfare, training and development, but it has set the framework. The previous human resources system in SOEs still influences recruitment. For example, previously, employees would expect their children to work in their firm. Currently, both state owned banks and commercial banks have three recruitment methods: graduate recruitment, open or agency recruitment and internship. However, state owned banks utilize targeted recruitment to employ those not fulky qualified but connected to the firm. The age limit for certain positions reduces incentives for senior employees who cannot be promoted, but there is greater flexibility on age criteria in the commercial banks. One significant improvement is the introduction of examinations in promotion and recruitment. While employees are likely to be promoted on the basis of personal networks, they must first demonstrate that they have reached the basic knowledge requirements. All banks have the same remuneration combination of basic salary, bonus and welfare benefits. SOEs lacked monetary incentives to improve performance, while banks currently use performance related bonuses. Banks, after reform, provide training and development. While state owned banks tend to focus more on management level employees, commercial banks tend to concentrate more on shop floor employees.

Table 10-3: Development of Resources and Capabilities: Human Resources

	2003	**2013**
Employment	Life time employment	Contract employment
Recruitment	Mix of unregulated company examinations and guanxi	Graduate recruitment: main method of CCB, BOC,ICBC Targeted recruitment: CCB,

		BOC, and ICBC Open recruitment: main method of commercial banks In general, primarily by CBRC regulated examinations, secondarily guanxi
Promotion	Primarily guanxi, secondarily performance	Primarily performance, plus examinations for specified posts, and secondarily guanxi Province level (Tier 1) or above: senior manager appointed by headquarters, with approval of CBRC Below province level: manager appointed at province level or city level
Training and development	Limited opportunities, largely reliant on on-the-job training	Structured and specialized training, plus formal qualifications and in general examinations Managerial training, on the job training, specialized training for specified roles, selective overseas training
Pay policy and welfare	Position and seniority pay and benefits	Mix of performance, position and seniority pay and benefits

10.4 Client and Customer Relationships and Product Development

Service firms need to prioritize the creation of intangible capabilities in skills and knowledge. In the banking sector, client and customer relationships and product development are key resources, and they are additionally closely

linked. Customer feedback can help to improve and develop products. In turn, good products and services can help to attract and maintain clients and customers. As in outlined in strategic management theories, long term and value adding relationships with clients, which are founded on a unique or distinctive service, cannot easily be imitated or substituted by rivals, and could offer firms a sustainable competitive advantage. Therefore, it is important to develop the capability of valuable client and customer relationships, as well as the capability of product development. More importantly, the aim is to make both of them more effective by ensuring that they enhance each other. All five cases generally divided their clients or customers into four levels, which are corporate client; medium to small (micro) firms client; individual VIP customer; and individual customer. They demonstrate that, to attract and keep relationships with corporate clients, small to medium firms, and individual VIP customers, 'guanxi' still plays an important role. Furthermore, products and services are important factors in attracting individual VIP customers, and became an important trend in Chinese domestic banks. The CBRC regulates that banks need to develop personal wealth management and private banking services, which Chinese banks did not operate before the period of economic reform. All of the five case studies prove that the banks made efforts to develop services for high-end customers. More specifically, CCB, BOC, ICBC and CITIC Bank cases illustrate that one important way to develop these services is learning from foreign partners. For the individual customer, also reliant on products and service, the banks developed the organizational resources needed. CITIC Bank and HXBC implemented the 'service focus' concept to improve good customer service to individual clients. Product development is based on individual customer requirements and more general market trends. For all the cases, the headquarters designed the products. The local branch could reflect customer feedback and requirements to the headquarters. For state owned and national commercial banks, at the province level branch, they could develop short term (under six months) products after

receiving approval from the headquarters and the CBRC. For the case of HXBC, which is a province level commercial bank, local branches could not develop products and services, but they did pass on customer feedback and requirements to the headquarters.

The five cases show that, firstly, Chinese banks started with improving the appeal, look and structure of their sub-branches. Secondly, they expanded self-service, including ATMs, to reduce waiting times and to improve the efficiency of their operations. Compared to commercial banks, state owned banks tended to focus on developing products rather than providing customer service. CCB leant how to develop products from its foreign partner, the Bank of America. For example, CCB has established customer experience centres in selected cities, with the aim to collect customers' opinions and feedback to improve its products. CCB developed personal loans to meet the requirements of customers. However, overall, in the Chinese banking sector, personal credit history systems have not been well developed, which results in difficulties when providing loans to individual customers. When CCB agrees to provide loans to individual customers, the process is always very time-consuming. BOC did not, however, emphasize customer service as much as the commercial banks, which are not former state-owned firms. Personal foreign exchange settlements, currency sales, and personal international remittance are one of BOC's traditional services, and one of its competitive advantages. BOC mainly focuses on developing and providing RMB and personal foreign exchange products to its individual customers. Compared to the non-former state-owned commercial banks, ICBC's customer services still need to be developed, compared to the other non-former state-owned banks, but ICBC provides better customer services than the other former state-owned national banks. ICBC was original established by the Chinese government to take responsibility for commercial banking activities in urban areas. Therefore, it

has competitive advantages in these markets with a large number of individual customers. ICBC has three main ways of collecting customer feedback. Firstly, the customer offers feedback to the local branches, and then the local branches report back to ICBC headquarters. Secondly, ICBC hires third parties to collect customer feedback. Thirdly, ICBC invites customers for pre-launch product and service events, and customers can reflect their suggestions immediately. The procedures show that customer feedback is one important force to help ICBC to improve its products and services. ICBC particularly focuses on the development of its card business. ICBC and American Express Company developed different types of credit cards to different Chinese domestic customers. ICBC, later on, applied the same approach to developing its own card business. It shows that the impact from the foreign partner tends to be significant in product and service development. ICBC improved its customer data systems, which could provide information and assist marketing activities for targeted customer groups. Compared to former state owned banks, national or province commercial banks put more effort into improving services to individual customers. China CITIC Bank implements a 'customer focus' business concept and puts the customer service in first place in its retail banking business. CITIC Bank keeps innovating its service and product range. For example, CITIC Bank developed different types of deposits for individual customers to apply for loans for their mortgages, cars, and tuition fees. CITIC bank maintains personal housing mortgage loans and credit card loans as its core businesses. HXBC provides the best customer service amongst our five cases. It emphasizes the training of employees to provide good customer service, although CBRC places limits on its service and product range. HXBC has the competitive advantage of providing efficient and fast services. But it has a potential disadvantage in its processes for evaluating customers, which might result in non-performing loans. HXBC has improved its products within the limitations set the CBRC.

On 25 March 2013, CBRC issued the Notice on Matters Concerning the Regulation of Wealth Management Business of Commercial Banks, further regulating the development of wealth management business, and playing an active role in standardizing the business structure of commercial banks and mitigating wealth management risks. Therefore, all banks developed services and products for high-end customers, and they were able to respond to market demand as well the regulation from the CBRC. The cases show the importance of individual VIP customers in domestic banks. The banks normally divide their individual VIP customers into three levels. The first is VIP customers. The second level is wealth management. The third level is private banking. Different banks have different requirements for savings or loans for each level of client, but the requirements are similar. Then, each bank has designed different services and products for each level. All five cases set up VIP or wealth management centres at selected branches to provide professional consulting and investment advisory services. In the case of CCB, personnel from the Bank of America work in the wealth management and private banking department as a part of their strategic alliance agreement. CCB learnt how to develop individual VIP customers from its foreign partner. Services included the right of family members of VIP customers to enjoy the same benefits. VIP customers can also gain from non-financial services, such as CCB organizing different social events based on individual interests and located, for example, golf clubs.

BOC is in strategic alliance with UBS AG to learn how to develop wealth management, and provided training to its wealth management advisors and managers. BOC cooperates with other firms to provide extra benefits to customers apart from financial products and services. For example, as a member of BOC's wealth management scheme, customers have extra benefits in Chinese domestic airports, and assistance from BOC partners

when overseas. ICBC seeks to develop products and services for customers. In the meantime, it conducts marketing to promote its current products and services toward new customers. For example, ICBC launched precision marketing campaigns amongst target customers, and scaled up the Elite Club Account service for them. ICBC emphasizes the training of employees so that they are qualified to offer wealth management services. ICBC focused on providing channel services to customers, by providing mobile banking and internet banking platforms, as well as by releasing the 'ICBC Private Banking' and the Wechat service platform for high-end customers. Moreover, it set its global product research and development unit in the Hong Kong Private Banking Centre. ICBC improved its private banking management product lines and services by leveraging interaction of the group's domestic and overseas operations. In the case of CITIC Bank, there are personnel from BBVA working in the wealth management and private banking department. CITIC learnt how to develop wealth management and private banking from its foreign partner. For example, CITIC Bank focuses on design tailored products and provide premium services for wealth management and private banking clients. CITIC also established an online platform only for private banking clients, with the aim of enhancing direct interaction between headquarters and customers. CITIC consistently provides training to private banking department employees. In the case of HXBC, there is no foreign partner involved at any level. Most of its VIP customers are connected through 'guanxi'. However, it cannot be considered as a sustainable competitive advantage, as clients who have been brought by 'guanxi' can be easily lost through 'guanxi', when managers leave for another firm.

Under the regulation of CBRC, each bank must support the development of small and medium enterprises. State owned banks traditionally provided loans to state owned firms, even if those SOEs might not be able to pay back. In

such instances, the Chinese government would help the SOEs to pay back, or help the banks to write off bad debts. State owned banks always considered small and medium firms therefore as high risk. As the CBRC regulates the percentage of medium to small enterprise business each bank needs to achieve, former state owned banks started to adjust their strategy. CCB learnt from its foreign partner, the Bank of America, how to manage and control risks with small to medium firms, as well as developing products and financial services for them. BOC started to improve its credit authorization and product system for small and medium sized enterprises by learning best practices from its strategic investors. Firstly, BOC has simplified the process of providing loans to small and medium enterprises, with the aim of providing more efficient and convenient services. Secondly, BOC based on the feedback from SMEs, developed short term financing products. It created a separate risk control management system for micro-sized enterprises, in order to provide faster services for them. However, small to medium enterprises are still not BOC's main clients. Similarly, ICBC adjusted its business strategy on small to medium firms, and enhanced its relevant risk control management. However, its process of providing loans to small to medium enterprises is still based on strict conditions and noted for its slowness.

Yet small and medium enterprise is the main business for national or province level commercial banks. One important reason is that non-former state-owned commercial banks face difficulties in competing with the former state owned banks to gain large corporate clients. The CBRC retains restrictions on these commercial banks in operating business in certain sectors. CITIC bank made efforts to provide products and services for small to medium firms. For example, it developed different types of deposit accounts for small or medium enterprises applying for loans to expand their business. Similarly, HXBC's main client is small to micro firms. 'Guanxi' plays an important role for

attracting this group of clients. Both CITIC bank and HXBC tend to hire senior managers from other banks who can bring in clients. Therefore, it cannot be considered a sustainable competitive advantage

Compared to CITIC and HXBC's focus on the development of small to medium or micro enterprises, three former state-owned banks tend to serve large corporate customers. CCB traditionally has advantages with large construction enterprises. BOC's main business is always corporate business, particularly in the areas of foreign exchange and international trade. ICBC has advantages with large urban enterprises. Institutional links in public utilities, health care, life assurance, education are an important part of the bank's corporate finance business, but former state owned banks tend to have a monopoly over these opportunities, as regulated by the CBRC. The policies of large institutional clients were influenced by the agenda set by CBRC. In the case of CITIC Bank, one of its competitive advantages is to integrate services for corporate clients from across the CITIC Group. For HXBC, the province level commercial bank, it tends to have contracts with local institutional business and local governments, showing a dependence on 'guanxi' as against some capability it has evolved.

The five cases show that their respective headquarters design and develop products. In the province level branch, they can develop short term (under six month) products, after approval from the CBRC. In the city or sub branch, they cannot develop products, but merely give feedback to the province level branch, and then to the headquarters. The CBRC regulates the percentage of each type of banking business every firm should have in the totality of its operations, which directly influences bank strategy. The three former state owned banks cases prove that, only after the regulation had been imposed by

the CBRC on targets for small and medium firms, did they adjust their strategy, leading to the development of products and improved services for small to medium firms. National commercial banks or provincial commercial banks (those never directly owned by the state) tend to focus on small to medium firms as their main clients, because they are too weak to compete or formally restrained from competing with state owned banks for large corporate clients. All five cases show a trend in developing products and services for high-end individual customers, again because of CRBC policy. One reason is that high-end individual clients constitute a large potential market. CCB, BOC, ICBC and CITIC learnt how to develop wealth management and private banking business from their foreign partners. Products and services are two key elements to attract this group of customers, although 'guanxi' should not be downplayed. Particularly, for HXBC, constrained by the CBRC, most of their high-end individual customers are based on 'guanxi'. Overall, it shows that the CBRC is still the major force for changes among Chinese banks., although foreign partners helped Chinese banks to learn 'best practice' more quickly, and customer and market demand also provokes organizational change.

Table 10-4: Development of Resources and Capabilities: Client Relationships and Product Development

	2003	**2013**
Product development	Basic products with low service quality, low incentives for change and innovation	Change as a result of market demand, institutional direction, and influence from foreign partners Designed and developed by headquarters, with approval by CBRC. For national commercial banks, province level can develop financial products with

		subsequent approval of headquarters and CBRC
Client relationships	'Guanxi' relationship dominant	Mix of product, service and 'guanxi'

10.5 Information and Technology

The integration of skills, knowledge and technology enable a bank organization to provide particular benefits to customers. For example, technology could help the development of online banking, mobile banking, and self-services, thereby offering more convenient service to customers, and improving the customer relationships. The cases studied show that they all realized the importance of the development of information technology. Online services, ATMs, telephone and mobile services could serve customers outside of office hours, reduce waiting terms at counters, and increase the efficiency of internal operations. Online banking or mobile banking for corporate clients and individual customers were supplied separately. The development of multiple channel service constitutes service enhancement. The development of information technology and management systems does not only help to improve systems and facilities for the end-user customers, but allows each bank to improve their management systems. Each bank integrated new technological applications and improved their back office management process. All banks started using social media such as 'Weibo' and 'Wechat' to conduct marketing activities and to collect customer feedbacks and requirements directly. CCB, ICBC, and CITIC Bank have put extensive resources into their IT capabilities. CCB, ICBC and CITIC have won an innovation championship competition every year to encourage technology innovation. However, BOC and Huarong Xiangjiang are some way behind the other three. BOC only made its online and mobile banking available to different

devise users in 2012. But BOC has started to offer its online, mobile and telephone banks to certain of its branches overseas. Similarly, ICBC began to provide those services to selected overseas branches. The HXBC case shows that, as a provincial bank, it has limited personnel and higher costs for developing its own technology or information system. Therefore, most of its information systems or management systems are sub-contracted. Compared to the big national commercial banks, its capability tends to be limited.

In the area of information technology development, the CBRC has no direct influence. Market demand played the dominant role for changes in service channels. All five cases used customer feedback to improve their services and to develop products. Also, the impacts from foreign partner tend to be more significant. In CCB, there are personnel from the Bank of America to help technology development. Also, the impact from the foreign partner tends to be more significant, which helps to explain why Huarong Xiangjiang has been left behind comparatively.

Table 10-5: Development of Resources and Capabilities: Information and Technology

	2003	**2013**
Online banking	Limited function and service	Corporate and personal internet banking, replacing certain traditional services
Mobile banking	Limited function and service	Personal mobile banking
Telephone banking	Limited function and service	24 hours service
Self service facility	Limited function and service	Updated facilities and service

10. 6 Analysis: Capability Development and Institutions

10.61 Causes of change in Chinese banking

This research considered established ideas on the role of institutions in developing and transition economies, which highlight the concept of 'institutional gaps' holding back the process of market reform and take the views that in these circumstances the state is a block on economic development. These views contrast with those that see developing economies as able to create institutions that are actively involved in the long-term building of a more competitive economy. As we have seen in the case of the Chinese banking industry, since 2003, the Chinese Banking Regulatory Commission (CBRC) has been at the forefront of encouraging the adoption and development of what it has determined as 'global best practice' in banking. We know, too, that strategic alliances with or foreign direct investment (FDI) by foreign companies can be a source for knowledge acquisition and the transfer of 'global best practice'. This assessment has been notably true with respect to China since the beginning of the 'open door' policy and the arrival of foreign multinational companies, which transformed the country's manufacturing. China provides clear evidence of core capabilities being transferred to multinational subsidiaries and joint ventures, even if debates continue on the extent to which practices can be adopted or have to be adapted. While Chinese manufacturing achieved the status of global competitiveness, other sectors such as banking remained comparatively unreformed in their levels of competition and in the retention of established management practices. Nevertheless, it is possible to say that FDI and the cross-border transfer of practices and capabilities can have a significant impact on a host country.

This thesis asks to what extent inward FDI has had a similar impact on the extensive changes introduced to Chinese banking since 2003, and had a direct and positive effect on core capabilities. It additionally raises interesting questions about the role of a key institution, the CBRC, about the efficacy of its policies and the reasons why it might have had a major part in the evolution of a service sector such as banking. As we have seen, FDI by itself cannot adequately explain how capabilities could be transferred or evolved at the operational branch level of Chinese banks. Left to their own devices, even if in partnership with foreign multinational, individual Chinese banks would not have reformed their entrenched traditional business practices, nor accepted increased levels of competition in the industry. The evidence from the case studies indicates additionally that banking services can only be created through interaction with clients and through the operation of client networks. Success ultimately depends on personnel and on the levels of experience, training and qualifications. At the operational level, branches might potentially resist change, or create a diversity of outcome, doubly so since provincial governments had traditionally been influential in the investment decisions made by banks with their provinces. The CBRC has the capacity to gain knowledge of 'global best practice', and to the legal and regulatory power to enforce new practices and standards. Moreover, it can set policy for the whole industry, and bring about the more rapid transformation of individual Chinese banks across the whole sector. Inevitably, the drive to force through change at a fast rate leads to similarity in the practices of banks, and the key question is to what extent banks have enough freedom to develop their own distinctive capabilities. As we are investigating a period of transformation, it is possible to see examples of hybrid local and international systems, and this mixing provides examples of varying management policies between Chinese banks. Overall, we perceive the substantial contribution of FDI partners to the transformation of Chinese banks, but the more direct and more notable impact

of the CBRC on the policies of their headquarters and on the operations of branches.

This thesis demonstrates how a national institution – such as CBRC – has been able to progress the transformation of an industry. If we go back to the theories of national institutions, the emphasis is on top-down isomorphic pressures, in which national institutions such as the state, finance, law, or education systems fundamentally determine the nature of firms and their management. Within this literature, debates exist on how much scope is left for entrepreneurial or managerial initiative, and on the extent to which variations in firm-level are possible. But there is small indication of how institutional isomorphic pressures shape firm and managerial characteristics, and the processes involved. One contribution of this thesis is to look at the mechanisms by which the CBRC has affected the resources and capabilities of Chinese banks, and, in order to provide adequate evaluation, to do so over a lengthy period. The case of the CBRC demonstrates an instance of leadership from a national institution established to drive the pace of economic development in China. However, the importance of local agency and specific client needs in the banking industry must be considered, as practices have to adapt in order to be the 'best fit' to local conditions. The unit of analysis is the individual bank, as the best means of assessing management initiative and client interaction, but also as the optimum means of demonstrating the impact of foreign multinationals and institutions on management practices. The thesis looks at the resources and capabilities that are core to success in banking, and focuses on matters of human resources, remuneration, training, qualifications, products and services, technology, and client networks. The comparative case studies enable an assessment of the extent to which Chinese banks can be differentiated from each other, and the extent to which changes are driven by firm-level capabilities as opposed to external influences. For the recent

evolution of Chinese banks, we can perceive the link between internationally transferred practices and strategic capabilities and the even stronger link between institutional influences and firm-level capability. We can ask therefore to what extent we can employ ideas in strategic management such as the Resource Based View (RBV) to analyse the nature of firm-level capabilities in Chinese banking. We can ask, too, to what extent the Dynamic Capabilities Approach (DCA) allow us to incorporate and judge influences external to each bank, such as international capability transfer, reforming institutions, or markets, and to account for the enhancement of capabilities over time.

To what extent and in what ways have China's banks been able to develop their strategic resources and capabilities in personnel, products, client networks, and information technology as required by increasing domestic and international competition?

No detailed case study of China's banks has focused on analysing their strategic resources and capabilities, nor described empirically what has occurred or changed in the industry in the last decade or more. There is a further need to study the evolution of Chinese banks in the long term, and to demonstrate the emergence of sustainable competitive advantages from the previous system. There is a gain to defining which resources and capabilities are suited to the banking sector for the period of China's transition and its particular institutional context.

Since 1978, the Chinese government has led the reform of the Chinese banking sector. It split commercial banking from regulatory and supervisory central banking, and gave the commercial functions of the People's Bank of China to four state-owned banks. Next, it sought to transform a policy-driven

banking system into a more market-oriented one, by allowing the four state owned banks freedom to operate commercial services in all banking services, and by enabling the establishment of local commercial banks. Having removed the restrictions on the state-owned specialist banks, the government made them, under the 1995 Commercial Bank Law, responsible for their own losses.

When China joined the WTO, in 2002, the banking sector still had problems with low efficiency and poor management, and was unsuited for international competition. In 2002, the Chinese government held the Second National Financial Work Conference, which concluded that problems remained with Chinese banking, namely the incomplete supervisory system, the inefficiency of the banks, a weak legal framework to protect and regulate the sector, a lack of staff with specialized financial knowledge and skills, poor internal organization, and low technological innovation. In 2003, the Chinese government decided to restructure Chinese banks through four main methods: capital injection; granting the banks approval to issue bonds to supplement their capital; the disposal of non-performing loans (NPLs) through asset management companies (AMCs); and permitting the introduction of foreign strategic investors. The important steps in completing the supervisory system were the establishment of the CBRC with the purpose of reforming the banking sector. This research investigates three state owned banks (CCB, BOC, ICBC), one national commercial bank (CITIC Bank), and one province level commercial bank (HXBC), and analyses all of them at an operational level. The findings indicate that the regulatory institution, the CBRC, took on the role as the leading force of reform, after its launch in 2003. Therefore, compared to 2002, the Chinese banks system has more complete and effective supervisory framework. More importantly, the CBRC is responsible for the restructuring of Chinese banks, and for transforming them from government organizations into more market-oriented or client responsive firms. It started with changes in the

ownership of Chinese banks, from 2003 onwards, and guided them to be shareholding companies and possibly to list on the stock market. Large amounts of capital were injected to Chinese banks through their new ownership structures, mostly through capital or asset management firms established and directly controlled by the Chinese central government, such as the Central Huijin Investment Company.

The problem of a lack of staff with specialized financial knowledge and skills has been gradually solved through the reform of human resource practice. There were a large number of initiatives, but four major changes from practices established in Chinese banking should be noted. Firstly, the ending of the lifetime employment system for the contract system helped Chinese banks to reduce redundant employees and improve operational efficiency. Secondly, the introduction of examinations in recruitment and promotion became the basis for selecting capable employees. Thirdly, training and development programmes helped to improve the skills and financial knowledge employees, and, fourthly, changes in payment brought measures of incentive. In product and service development, banks became more adept at taking account of customer opinion. For example, they introduced credit cards targeted at particular customers, specialist wealth management accounts and services, and greater use of IT and mobile banking facilities. Client networks were transformed in operation because firms were obliged to compete in all aspects of banking and because they began to recruit talented staff from rivals. What can be perceived is an investment by firms in their capabilities. Human resources and IT were seen as needed core capabilities in the development of the banking sector, and as important components to evolving new products and services and being more responsive to clients.

The CBRC began its reform of the banking industry with significant changes in the ownership and governance structures of banks, and, through the foreign multinationals it allowed to invest, it initiated important improvements in technology levels. One motive was to make government influence less direct, and to encourage competition between banks. Another outcome through the founding of shareholding structures was to enable investment by foreign multinationals. In the pursuit of enhancing firm-level capabilities, the CBRC encouraged Chinese banks to cooperate with foreign firms in order to learn 'best practice'. An obvious example of the influence of foreign multinationals on Chinese banks was the introduction of IT systems. The CBRC was careful to regulate that foreign banks could only operate in selected aspects of banking and in specific areas of China, which indirectly forced foreign firms to ally with indigenous banks if they wanted to expand in the Chinese market. In order to protect domestic banks, the CBRC passed regulations that limited the percentage of shares a foreign firm might own in any one Chinese bank and within the domestic banking industry overall. The case findings show furthermore that Chinese banks developed levels of distinctiveness in their capabilities to develop products, maintain client relationships, and even in the use of new technology, such as online banking, mobile banking, and new social media for marketing. Overall, during 2003 to 2013, Chinese banks have begun to reform established practices in order to be more market orientated, albeit under the protection of the Chinese government, and, at the current stage, despite being too weak to compete in the global market.

How effectively does FDI theory adequately explain how capabilities and global 'best practices' have been implemented and developed at the operational branch level of Chinese banks?

For examples of FDI, in which a parent multinational owns or controls a subsidiary, or has a major stake in a joint venture, the foreign investor has in principle the mechanism for transferring its ownership capabilities. As we shall see, in the examples of Chinese banks, the levels of ownership and control open to a foreign investor was limited, but the transfer or adaptation of global best practice did occur. In exploring how new cases were embedded in Chinese banking, the cases in this thesis analyses to what extent they copied systems used overseas or introduced hybrid outcomes. Given its generalized framework, can FDI theory explain how capabilities and global 'best practices' were implemented and developed at Chinese banks' operational, within, or, crucially, at the subsidiary level?

Hymer (1960) states that the transfer of capital funds by themselves could not fully explain the overseas operations of firms. He explains that MNEs must have some 'ownership advantage', such as advanced technology, product or management skills that allows them to overcome the problem of being foreign. Hymer (1972) and Kindleberger (1983) argue the importance of protecting and transferring ownership advantages to subsidiaries and the need for strategic control by the parent multinational the coordinate overseas operations. Buckley & Casson (1976) integrate important ideas of internal coordination and transaction costs, and developed the internalization theory, which considers how firms could enhance competitive advantages through managerial hierarchies to improve performance. They further state that the reduction of transaction costs explains the motivation of cross-border operations. Dunning (1980) identify company's specific ownership advantages

(O), location advantages (L) and internationalization advantages (I) as the determining factors for the expansion of international activities, and offers the OLI framework. He suggests that a firm will engage in international production because it has specific ownership advantages it can exploit in a specific location, and can internalize these ownership and locational advantages to increase profits or achieve strategic goals. Ownership advantages can be effectively transferred, exploited and protected by a managerial hierarchy and corporate control through a process of internalization. Here the emphasis is mainly to explain the initial motivation and condition for FDI, alongside the necessary cross-border organization connected to that strategic motivation. The need control and the guarding of core capabilities makes FDI the choice over licensing.

One issue is whether leading FDI theories fully address the particular demands of services FDI (Sabi, 1988; Casson, 1990; Chen, 2009). Service MNEs ultimately seek new clients, new markets or assets at a particular location, and to exploit their ownership advantages. Most services – unlike manufactured goods - need to be produced in direct contact with the consumer. Service firms must therefore localize their services or establish person-to-person contact. In banking, organizational learning, quality of managerial resources, and internal coordination has been important factors for MNEs expanding overseas. Arguably, the level of localization of capabilities – given differing market and client needs – is greater than in many instances of manufacturing.

In combination with institutional rules for inward FDI, the need for localization and the importance of market entry have encouraged foreign banks in China to enter joint ventures. More generally, regulations and legal requirements may

raise transactions costs and limit international trade in services. Cho (1986) therefore proposes the need for an effective managerial structure or business strategy to help reduce transactions costs in foreign markets. As we have noted previously, when he suggests that multinational banks transfer capital, management, and technological assets across borders, they need to integrate those assets with knowledge of local markets, policies, regulations, consumer behaviour, if they are to retain the potency of their assets in different circumstances or to create new competitive advantages. They must, in other words, have the ability to achieve localization and internalization of adapted practices, much as occurred with manufacturing examples.

Access to skilled personnel, managerial resources, financial sources, efficient banking networks, knowledge, expertise with a particular customer type, and product differentiation are the main ownership advantages in banking. The attainment of these ownership advantages from multinational banks or foreign investors formed the key reason why Chinese banks sought international strategic alliances. The government has allowed multinational banks or foreign investors to enter China since 1979, but at this point they allowed only representative offices. In 1982, it agreed to multinational banks operating branches in selected regions. Even after China joined the WTO, and the Chinese government promised to gradually open the financial market, the CBRC still imposes many restrictions on multinational banks in terms of permitted areas for their branches and the range and type of business they could provide. Therefore, multinational banks or foreign investors looked to cooperate with local banks, by using their existing client network to expand business in China. Therefore, the peak time for strategic alliances between Chinese banks and foreign investors was around 2006. Chinese banks tend to look for partners that can provide them with improvements in product development, technology innovation, marketing skills, and distribution

expertise. The CBRC guides the Chinese domestic banks to cooperate with foreign banks, but did not point out which foreign investors they should cooperate with. Chinese banks have their freedom to choose their partners. The case findings, therefore, show that different banks had different concerns and strategies, leading to different choice of foreign partners. The China Construction Bank (CCB), and CITIC Bank chose to have one major foreign partner, as they believed it important to establish able a wide range and deep levels of cooperation to implement needed change. CCB chose the Bank of America as its main partner, and CITIC Bank chose the BBVA. The industrial and Commercial Bank (ICBC), on the other hand, selected multiple partners, with each chosen to supply a particular expertise for different areas of the banking business. While the expertise was more specific, the relationship with each partner was not so strategic and ultimately less stable. ICBC chose American Express to cooperate over credit cards, and Allianz as its partner for insurance business. Bank of China (BOC) used a combination of both approaches. It chose the Royal Bank of Scotland to help it to improve its banking business in general, particularly in risk management, governance, IT, wealth management, credit cards and corporate banking, but it chose UBS AG for its specific knowledge of investment banking and securities.

The case findings suggest that different corporate strategies and levels of cooperation resulted in different outcomes. In the case of CCB and CITIC, both of their foreign partners appointed personnel to departments in their headquarters, resulting in a long term and stable relationship. Therefore, CCB and CITIC extended their initial agreement with foreign investors, even if the percentage of shareholding fell. However, BOC and ICBC's foreign partners were less directly involved in the formation of policies at the headquarters. Therefore, RBS and USB AG over time sold up their shares in BOC, just as

Goldman Sachs, Allianz and American Express reduced their commitments in ICBC.

The cases findings show that foreign investors played a positive role in improving the areas of client and customer relationships and product development, as well as information technology. Since forming their international partnerships, Chinese banks expanded their self-services, including ATMs, which reduced waiting times and improved the efficiency of branch operations. They started to differentiate clients and customers into four levels. Chinese banks acquired knowledge on how to deal with private banking and wealth management from its foreign partners. CCB, ICBC, CITIC and BOC all learnt how to develop products and services to different customers and clients from their foreign partners. For example, CCB built a customer experience centre, and directly gained feedback from customers on how to improve products and service. ICBC in particular learnt how to develop its credit card business from America Express. But HXBC, as a provincial level commercial bank, does not have any foreign partners, and for most of its clients and customer it still largely relies on 'guanxi' as opposed to product or service differentiation. The integration of skills, knowledge and technology enables an organization to provide particular benefits to customers. The cases present the importance of the development of information technology and online and mobile banking, plus the use of online social media to promote their product and services. The four national commercial banks cases show that the foreign partners helped them to develop information technology. The provincial commercial bank, HXBC, without the help of a foreign partner, tends to lag behind those big national commercial banks in IT related services. Foreign partners had a perceivable impact on Chinese banks through the adoption of 'best practices', particularly in product development and information technology.

The one area of Chinese banking that underwent fundamental changes – human resources – cannot be explained by the influence of inward FDI. The move to contract employment, examinations in recruitment and promotions, and extensive training were important to an industry in which the quality of human resources determines its ability to deal with clients, respond to their needs, or develop new products. The cases reveal nonetheless that some vestiges of the old system – the use of guanxi amongst those that could pass examinations for recruitment and promotion – remained. We must bear in mind, moreover, that most of the foreign banks reduced their shareholding, and so failed to a larger extent to gain the market seeking goals that had originally attracted them to China. They are still awaiting further deregulation to see if they can exploit the knowledge and experience gained, but they would still face considerable entry barriers and local, operational contacts. As well as not being able to fulfil their commercial objectives, the advantages that the foreign banks owned could be understood and replicated by China's banks, and differentiated this service industry from aspects of manufacturing such as R&D capability. After a comparatively short time, the value of the investing foreign partner declined. The CBRC furthermore encouraged China's banks to learn from overseas, but sought ultimately to create competitive national industry, and did not want to facilitate a banking sector controlled by foreign multinationals. The institution too acquired knowledge on the nature of internationally competitive banking practice, and in combination with the banks could take an increasingly proactive role in the development of capabilities. Lastly, while we can detect the influence of multinationals on the formation of bank headquarters policy, they did not have the managerial influence or the resources to bring about widespread and multi-level change in any one bank. Indeed, in-built practices throughout each bank might have resisted the effective introduction of new practices. As a result, regulatory and strategic direction was important to the inculcating the lessons to be learnt from foreign

banks, as well as increasing important in framing new policies and introducing new practices.

To what extent is the CBRC, the formative regulatory institution, responsible for the development of capabilities in Chinese banks?

In a market-based view of transition economies, institutions as the instruments of a policy or regulatory culture being reformed are viewed as the problem. But, in the late development perspective, government and other institutions are essential drivers of economic development. We can legitimately ask if ideas about institutional failings holding back the process of market reform in transition economies reflect what occurred in China's banking industry. Similarly, we can review the notion of strong isomorphic pressures, in the theory of national institutions, being the force shaping the evolution of Chinese banks over time. Advocates of strong isomorphic pressures, as suggested by some explanations of institutional theory, would not allow much scope for Chinese banks to achieve variations or differentiation in capability, not give space for international forces of change to have a long term impact. In this thesis, the Chinese banking cases show that isomorphic pressures have not inhibited the development of firm-level or differentiated capabilities, nor prevented the transfer or emulation of international best practice. The China Banking Regulatory Commission (CBRC) has emerged as the major force for reforming banks and enhancing their capabilities.

Davis & North (1971) consider an 'institutional framework' as 'the set of fundamental political, social, and legal ground rules that establishes the basis for production, exchange, and distribution'. In other words, a country's established systems of government and law can provide the conditions that

allow markets and economic growth to function effectively. Institutions reflect also a set of values and norms that exist outside of firms and influence how the firm is managed and structured (Meyer & Rowan, 1977; Zucker, 1987). It is institutions that determine the nature of organizational practices. One of a firm's core competences is an ability to adapt to changes in external conditions and to assimilate new external information through utilizing its experience of the previous context. Whitley's national business systems approach considers that firms are deeply embedded in their institutions, and that institutions determine the structure of firms and the nature of management practices. The later new institutionalism strand considers the importance of strategy, and admits to some extent that firms have the capability to resist to a limited extent institutional framework. Nonetheless, they all ignore or downplay the human agency of firms and firm level action.

In international business study, institutionalist approaches raise the question of how powerful national institutions can accommodate the fact of international influence and global 'best practice'? Morgan & Whitely (2003) outline a range of transfer scenarios, depending on the strength of local institutions, or the ability of a multinational to achieve a high degree of cross-border integration. The outcomes tend to be adopting parent firm practice with minor alterations, the adoption of local practices, or the hybridization of transferred practices based on home and host country's institutional variations, cultural differences, market differences, and levels of economic development. Jefferson & Rawski (1995) state that in an emerging economy, such as China, economic success is the result of a market-led withdrawal of government controls, and increased property rights that provide the incentive for change. In reality, emerging economies often show elements of marketization and privatization mixed with strong institutions and regulations, and both have the potential to shape the

business strategies of firms. Institutions have a role to play in the emergence of competitive mechanisms, or in the development of firm-level capabilities.

The findings of this study of Chinese banks presents that Chinese institutions were the key force for the reform and development of Chinese banking sector. Particularly, after 2003, the establishment of the CBRC had a specific and formative role in supervising and regulating the banking sector. The first purpose was to protect the domestic Chinese banks, by helping to build an effectively banking system after near 30 years of reform. As we have noted, the CBRC directly guided the reform of human resource practices in Chinese banks. In order to break the traditional practice of life time employment, which encouraged low productivity, the CBRC instructed all banks to change from lifetime employment to contract. During this process, employees needed to pass exams related to the positions to which they were being recruited or promoted, which helped to improve the standing and qualifications of managerial positions and ensured the quality of employees. At senior levels, an employee's promotion needed the direct approval of the CBRC to ensure the capability of the personnel.

The findings in this thesis show that the CBRC was directly involved in bank product development and business strategy, since the purpose was to ensure that each type of business could be developed by each bank. Firstly, it regulated what types of business each bank needed to develop. For example, in recent years, the CBRC has emphasized medium and small enterprises as well as individual VIP customers. This has had direct impact on banks strategy. So, all the 'big four' banks, which had traditionally ignored business with medium and small enterprises, were given targets for the building of medium and small enterprise accounts as a percentage of total business. Also, banks

had to create capabilities that would enable them to provide product and services for high-end customers, a new market in China. However, the measures regulated by the CBRC were important in driving Chinese banks to develop a full range of commercial banking business with international standards as the benchmark. The CBRC involved itself directly in product development. All new products and services needed its approval before being launched. Although the 1995 Bank Law allowed all Chinese banks could compete in all sectors, the CBRC still regulated on which firm could enter which banking markets. As a result, the province level commercial bank, HXBC, does not offer as many products and services as the national commercial banks. The CBRC similarly approves initiatives in information and technology development.

Institutionalist perspectives, particularly in their early phase, perceive institutions as determining and shaping the structure of firms and the nature of management practices. The case findings from Chinese banks indicate that the leading supervisory institution, the CBRC, has been a formative influence on business strategy and management practice. New institutional theory has conceived institutions as the principal determinant of firm level practice, although more recent interpretations conceive of firms having diversity and scope for managerial action within firms and see firms as influencing institutions reciprocally. So far, the evidence from Chinese banking provides no clear case of firms influencing the CBRC or government policy. Once enhanced practices are identified and accepted by the CBRC, it can regulate that they are implemented by all banks. The thesis shows that, importantly in instances of emerging economics, strong institutions can be a major force for the adoption of global 'best practice'. The CBRC does regulate what percentage the foreign investor can own within a bank, and limits their involvement in management decisions. Its aim was to protect immature

Chinese banks and national ownership of the banking sector, and it never intended to curb engagement with foreign banks and the opportunity to learn 'best practice'. The case findings indeed illustrate how Chinese banks learnt 'best practices' from foreign partners, even if the CBRC proved more influential in promoting and enforcing the adoption of best practice.

10.62 Explaining change in Chinese banking

A main objective of the thesis was to identify the character of the change in management practices and capabilities in Chinese banking, and specifically since the government announced its plan from 2003 to make the industry internationally competitive, and to learn best practice from foreign rivals and investors. The firm-level focus of the research enabled the tracking of these changes from 2003 until 2013, and allowed the identification of core capabilities in the banking sector and in the context of China's institutional environment and economic development. The research demonstrates, moreover, what Chinese banks need to achieve strategically in order to obtain further improvements in their performance. In order to deepen our understanding of the capabilities and core capabilities of Chinese banks, the thesis presented an overview and analysis of the strategic management literature, most notably lessons from the Resource Based View (RBV) and the Dynamic Capabilities Approach (DCA). The thesis has been concerned with, firstly, demonstrating the nature of management change in Chinese banks, and, secondly, with the explanations of the causes of such change. We have seen from the case evidence that there have been two major formative influences: an alliance with a multinational through FDI, and the reform programme of the supervisory institution, chiefly the CBRC. The thesis offers new insights into how precisely alliance with a foreign multinational and, in particular, the influence of a key national institution can shape management

practice at an operational level, and, critically, shape the development of core capabilities that can lead to a sustainable competitive advantage. By utilizing and combining insights from the RBV and DCA, we can provide a fuller explanation both of the extent and of the causes of capability development.

As we have noted previously, the design school is considered as the foundation of strategic management theories. One of the key concepts of the design school is the SWOT framework: strength, weakness, opportunities, and threats. The SWOT provides the key terms of the business environment and the capabilities of an organization that are most likely to impact on its strategic development. The case findings reveal that, although China's banks have operated under the guidelines of the CBRC, the firms themselves have different strength and weakness (as the table shows below). In the case of state-owned banks - CCB, BOC and ICBC - they all have strengths in large corporate client business. One reason is their established long-term relationships with large SOEs. The other reason is that they have monopoly clients assigned by the CBRC. Even so, their main corporate clients are different. CCB's mainly focused on large construction firms, ICBC on large SOEs in urban areas. BOC concentrates on supporting large SOEs or those firms investing overseas. CITIC Bank is one of the largest national commercial banks, and it has strengths in small to medium enterprises. These clients have long been ignored by the large state owned banks, and, compared to state owned banks, CITIC Bank is still on a small scale and disadvantaged to compete with them for large corporate clients. For HXBC, as a province level commercial bank, it has a speciality in small to micro enterprises, overlooked by state owned banks and national commercial banks. All banks had opportunities for developing products and services for high-end VIP individual customers. CCB, BOC, ICBC and CITIC banks all have foreign partners to help them develop products and services for high-end VIP individual

customers, although ‘guanxi’ continued to play an important counter role to market competition. Compared to the larger firms, HXBC’s VIP individual customers largely rely on ‘guanxi’.

All banks could use information technology to develop online and mobile banking, self-service facilities, and new social media marketing strategies, as well as implementing management information system for internal control and for gaining first move advantages. CCB was the pilot firm chosen to develop self-service facilities; ICBC took the initial role in providing monitors at their banks to explain and expand self-service banking; CITIC Bank was selected as the first to provide a mobile banking system for all mobile users; and BOC was the pilot to provide online banking for its overseas clients. One of the reasons for state owned and national commercial banks leading in information and technology development, compared to province level commercial banks, is their alliances and ability to learn from their foreign partners. Unlike the large national banks, therefore, HXBC remains largely behind in the use of IT. In contrast to the commercial banks, the weakness of state owned banks is their service for individual customers, such as dealing with enquiries, although they realized the importance. Amongst our five cases, HXBC provides the best individual customer services, through emphasis in its training approach, followed by CITIC. State owned banks had traditionally ignored customer service, emerging as they did from the planned economy. While state owned banks place less strategic focus on individual customers, they still need to improve their basic customer service. More importantly, the CBRC regulates the percentage of business each bank need to achieve in each sector of banking, and every bank has a retail banking target. Since 2002, when China joined the WTO and promised to gradually open the financial sector within five years, the government has opened up the financial sector, although to a lesser extent than promised. The CBRC has allowed multinationals to set up their

own branches in selected areas and allowed them to operate more products and services in China. These initiatives suggest long-term threats to Chinese domestic banks, particularly in the area of high-end VIP individual customers, and they need to fashion competitive responses.

Table 10-6: Competitive Strength and Weakness of Chinese Banks

Bank	Strengths	Opportunities	Weaknesses	Threats
CCB	Corporate clients	Online and mobile banking High-end VIP individual customers	Lack of customer service for individual customers	Entry of foreign banks Expanding national and provincial commercial banks
BOC	Corporate clients in foreign exchange and outward investment	Online and mobile banking High-end VIP individual customers	Lack of Customer service for individual customers	Entry of foreign banks Expanding of national and provincial commercial banks
ICBC	Corporate clients and individual customers	Online and mobile banking High-end VIP individual customers	Lack of customer service for individual customers	Entry of foreign banks Expanding of national and provincial commercial banks
CITIC Bank	Small to medium enterprises Good individual customer Service	Online and mobile banking High-end VIP individual customers	Lack of strong corporate clients	Entry of foreign banks Expanding provincial commercial banks

HXBC	Small to micro enterprises Good individual customer service	Online and mobile banking High-end VIP individual customers	Lack of large corporate clients Lack of foreign partners	Entry of foreign banks Expanding of other provincial commercial banks Tighter restrictions from CBRC on provincial banks

The positioning school argues that the external framework is needed to analyse a firm's competitive advantages. It relates strategy to the attractiveness of an industry in which a firm competes, and to the relative position of the firm in that industry's value chain, from which it can derive the greatest competitive advantage. Porter introduced two frameworks: the five forces framework and the generic competitive strategies. Porter's five forces includes the bargaining power of buyers, the bargaining power of suppliers and buyers, the intensity of rivalry, the threats of new entrants, and the treats of substitutes, and forms a tool for firms to analyse their external environment and to deal with potential threats. Our five cases illustrate how the Chinese banking sector is highly controlled by the Chinese government through the CBRC. The bargaining power of buyers and suppliers is weak, and the threats of new entrants and substitutes are low. Although Chinese banks are free to compete with each other, as the regulation from the CBRC facilitates, the level of rivalry is limited.

The premises of positioning analysis are that firm profitability and growth are determined by its strategic position within an industry. Porter (1985) bases his

ideas on competitiveness on a firm's relative position within its industry, which determines whether its profitability is above or below the industry average. He developed three generic competitive strategies: cost leadership, differentiation and focus that a firm could pursue to enjoy superior performance in its industry. Chinese banks cannot implement a cost leadership strategy, as the CBRC regulates their product and service prices. Chinese banks can however choose to implement a differentiation and focus strategy. Although, since 1995, the Chinese bank law regulates that firms could compete with each other in all sectors. In reality, the CBRC does provide monopoly business to certain banks, and regulates that provincial commercial banks must operate from selected products and services. Therefore, many Chinese banks, particularly provincial commercial banks, can use focus strategies and operate in those areas ignored by state owned banks or national commercial banks. Historically, the Chinese government divided the tasks for each state owned banks and other commercial banks. For example, CCB was responsible for conducting business in the construction industry and supporting large government projects. BOC was responsible for foreign exchange business. ICBC was responsible for large urban SOEs. Nonetheless, these legacies continue to influence current bank operations. For example, CCB has an advantage with corporate clients in the construction industry. BOC has the lead in foreign exchange business. Not surprisingly, Chinese banks have built upon these historical specialisms, and used their advantage to differentiate themselves from other banks, as the table below.

Table 10-7: Competitive Positioning of Chinese Banks

	Differentiation	Focus
CCB	Corporate clients	Construction industry
BOC	Corporate clients	Foreign exchange and outward

		investment
ICBC	Corporate clients Individual retail customers	Industrial and urban corporate clients Urban areas
CITIC Bank	Superior customer service	Small to medium enterprises Individual retail customer
HXBC	Superior customer service	Small to micro enterprises Individual retail customer

The prescriptive schools and the design schools tend to focus on how firms should respond to external factors, and how firms adjust product development, operations, marketing and support services accordingly to sustained competitive advantage. Firms should react strategically to opportunities and threats outside the firm by identifying and utilizing the resources they control, and, as a result, it is the external environment that influences a firm's development. The cases findings indicate that, in the Chinese banking sector, the strong institutional framework affects firms similarly, but the long-term objective is to create differentiated firms with their own competitive internal capabilities. The resource-based view seeks to provide an answer by concentrating on how firms evolve their internal capabilities, and, in a reversal of previous interpretations, on how the resulting competitive advantage has an impact on the external environment.

Penrose (1959) depicts firms as a set of resources, and its expansion involves either exploiting existing resources or developing new ones. Williamson (1975) considers that, for the growth of firms, relevant resources are physical capital (plant, equipment, and raw materials), human capital (training, experience, and skills), or organizational capital (formal reporting structure, and

coordinating systems). Wernerfelt (1984) was the pioneer of the phrase ‘resource based view’, and divides resources into tangible assets such as plant and intangible assets such as the brand name. He adds that a firm can own a resource that gives it an advantage at a specific point in time over those firms not in possession of such a resource or something similar. Barney (1991) states that a firm develops heterogeneous resources to differentiate it from competitors and that these resources are imperfectly mobile between firms. A firm’s resources can determine strategy, which are emergent within a firm. Grant (1991) argues that not all resources can help firms to gain competitive advantage, implement valuable strategies, or improve effectiveness and efficiency. He further proposes the idea of sustained competitive advantages, based on resources that are difficult for rivals to imitate or match in exactly the same way.

In the Chinese banking sector, in which the market environment is highly regulated, domestic banks have little flexibility in deciding how to respond to external developments. Chinese banks do seek, however, to improve their internal resources such as managerial ability and technological know-how. There is a link between interaction with clients and the building of internal capabilities. Chen (2009) argues that the maintaining of good relationships with clients is the key capability in the banking sector, and the case findings have discovered the ways in which Chinese banks have tried to maintain their client relationships. Although the CBRC regulates the percentage of each sector of banking that a firm needs to achieve, it does not provide guidelines on how each bank should achieve its targets. Therefore, each bank can focus on client relationships and act in response to market demand and client requirements. One of the methods Chinese domestic bank choose to improve their client relationships is cooperation with foreign partners and learning from them how to develop products and services that keep and attract clients. The

findings prove that providing good customer service through the training of personnel is another way to maintain and improve client relationships. Technology and information development is an important capability in the banking sector. Chinese banks have cooperated with foreign partners in order to improve their technological know-how. One significant finding is that, compared to CCB, BOC, ICBC, and CITIC Bank, all of whom had foreign partners, HXBC remained deficient in the area of information and technology development.

The RBV is concerned with the importance of specific resources in creating competitive advantages that contribute to a firm's development. However, it does not clearly explain how firms could achieve competitive advantage by the implementation of a strategy. Teece et al. (1997) state that dynamic capabilities refer to the capacity to renew competences to achieve congruence with the changing business environment. Therefore, innovative responses are required when time to market and timing are critical, the rate of technological change is rapid, and the nature of future competition and markets are difficult to determine. Dynamic capabilities refer to the abilities of a firm to achieve new competitive advantages. It emphasizes a firm's ability to integrate, build and reconfigure existing resources for this purpose. Chinese banks have forged strategic alliances with foreign multinational investors, creating new resources and competitive advantages, particularly for developing products and services, as well as information technology. The cross integration of product, service and advanced information technology further assisted banks in building effective long-term client relationships. Client relationships themselves constitute an important resource in the banking sector, and client interaction can be the foundation for strengthening the supply and development of products and services. Collecting customer feedback on products and services could help to shape products and services. The notion of dynamic capabilities

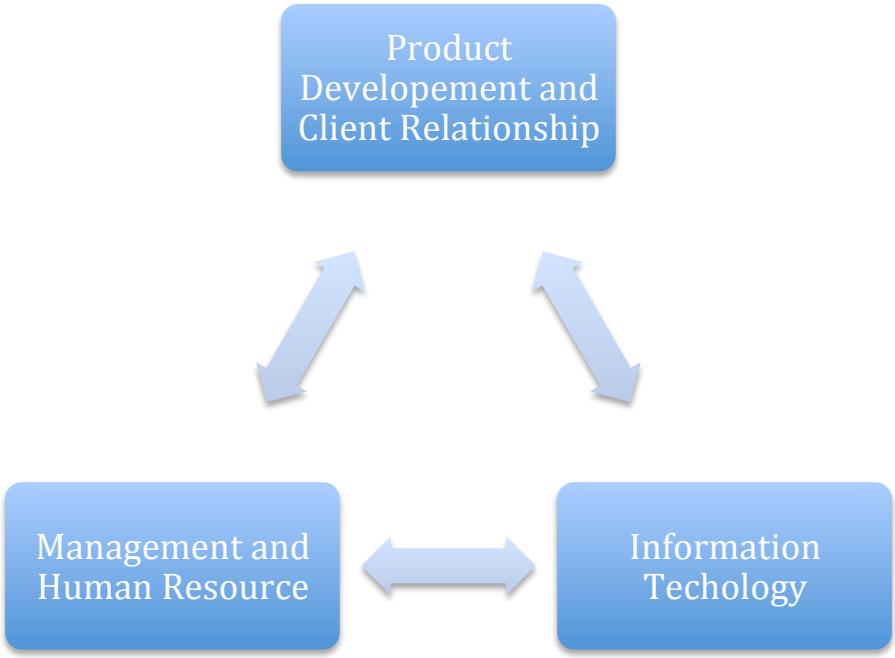
is based on interpreting and responding to external sources of information and feedback, and then reconfiguring internal resources accordingly, and this is a good description of how to improve client relationships in banking. In recent years, as the number of social media users has grown, Chinese banks began to operate social media platforms, which directly communicate with customers, and made the collection of customer feedback even quicker, whereby banks can respond to market demand in time. The Chinese bank cases gradually realized that they were part of a service industry, rather than government institutions, and they have made efforts to collect customers' opinions and improve services and products. As information technology has been developed, it can also help to build long-term customer relationships. For example, ICBC developed its 'big data' management system, which could store all customers' information, and consequently they could promote or offer tailored products and services. Online training programmes provide more up-to-date training for employees, and focus on how staff can recommend suitable products and services to customers. The cases show that Chinese banks have dynamic capabilities to respond quickly to institutional pressure and regulation. To give one further example, when the CBRC encouraged the development of wealth management business, Chinese banks adjusted their strategies and their service portfolios.

The Resource Based View in strategic management can provide insights into the nature of firm-level capabilities. Can it, however, be the basis for an adequate analysis of the evolution of Chinese banking over time? Consequently, can the Dynamic Capabilities Approach allow us to incorporate the external influences that have shaped the process of change in Chinese banking? What this research adds to the discussion on dynamic capabilities is that the list of external forces on internal firm resources should be extended from market and technological changes to include institutional pressures or

regulations, most obviously in instances of developing or transition economies. It is possible to state that, in contrast to the example of many manufacturing initiatives and the rise of Chinese industry, there is a more important link between institutional influences and firm-level capability. Moreover, and again especially so in the circumstances of developing or transition economies, we should include the role of strategic alliances, joint ventures, and the international transfer of capabilities and know-how by multinationals as an external factor. The cases studies have been revealing by showing the process by which external factors – a particular combination of institutional change, multinational capability transfer, market reform, and technology acquisition – brought about a transformation in resource and capability transfer over time within banking firms. The thesis shows the development of bank resources and capabilities in China during the period since 2003, and focuses on matters of human resources, remuneration, training, qualifications, products and services, technology, and client networks. Because it takes a comparative firm-level approach, and because it focuses on the processes of resource and capability change, it can achieve the dual objectives of linking environmental influences and internal transformation, and indicating differences in internal processes and outcomes. It follows that there has been scope – although the capability levels between Chinese banks and multinational partners remains significant, and although the institutional pressures from the CBRC remain strong – for differentiation in resources and capabilities in the Chinese banking sector.

Figure 10-1: External Factors Determining Development of Chinese Bank Capabilities

Figure 10-2: Internal Factors Determining Development of Chinese Bank Capabilities



10. 7 Implications and Assessment

The comparison and analysis of case evidence have brought insight into how institutions and FDI have shaped Chinese banks and firm-level capability, and they have shown how Chinese banks were able to develop capabilities at an operational level. Firstly, and from perspective of theory, this thesis finds that ideas in the FDI literature can explain why capabilities or specific capabilities are transferred from a foreign partner or multinational to a Chinese bank. The case evidence in addition offers new insights into how the process of resource and capability transfer is conducted and implemented. On the other hand, the role taken by multinationals could not fully explain all aspects of firm-level change or the extent of change across the industry as a whole. Secondly, contrary to the widely-held view that institutions must be a barrier to competitive mechanisms driving the pursuit of global 'best practice' in emerging economics, this thesis suggest that the CBRC has had a formative place in the transformation of Chinese banking. This key institution, regulator and supervisory body facilitated multinational investment and joint venture arrangements, and furthermore regulated to improve practices in all aspects of management and in key banking capabilities. It imposed restrictions that protected the ownership control and management decision-making of Chinese banks from foreign partners and investors, securing their long term future as competitive indigenous enterprises and gaining the time needed to learn from best practice. Unlike the typical role assumed regulatory bodies in developed economies, in the finance and banking sector, the CBRC was given the task of changing the strategies, management, organization, and competitive capabilities of individual banks and the industry as a whole. Thirdly, the thesis has shown the process by which Chinese banks improved their core capabilities, and demonstrated the direct link between that process and external factors such as national or institutional forces and global or multinational investor influences. Fourthly, this thesis shows that Chinese

banks have the capacity to develop levels of distinctiveness in their capabilities and competitive advantages, consequently differentiating themselves at an operational level, although regulatory restrictions remain. In addition, this thesis demonstrated the interaction and combination of various factors, both external and internal to the firm: MNE inward investment and global 'best practice; institutional and regulatory forces, most obviously the CBRC; market and technology trends, and the emerging requirements of clients and customers; economic development; and changes in management structure, firm-level competitiveness, IT and communication technology, client relations, products, marketing, and human resources and skills. From the practical perspective, this thesis tracks the changes in Chinese banking since the reform from 1978, and particularly after the establishment of the CBRC in 2003. It has investigated the causes of the changes and the development of firm-level capabilities. A contribution of this thesis is that it provides a detailed case study of China's banks at an operational level, and shows change in practice by looking at institutional factors, FDI, and management agency.

For the further development of Chinese banks, this thesis has the following implications. Firstly, in terms of ownership control and strategy, it suggests that Chinese banks can gain from a strategic alliance with MNEs, but there have to be mechanisms for ensuring mutual benefits are achieved in pursuit of a long-term cooperative relationship. Secondly, the case evidence shows that Chinese banks at the provincial level or city level should have more authority to design and develop products and services for a quicker response to market demand and client needs. Thirdly, in terms of human resource management, Chinese banks need to invest further in the training of employees, particularly for providing 'customer service'. Chinese banks could remove the age limitation in promotion or recruitment, and focus more on overall performance. Internship programmes should be used as a channel to discover talented

employees rather than as a way to maintain ‘guanxi’. Fourthly, in terms of product development and client relationships, Chinese banks and particularly former state-owned banks need to stress customer service and product development for customers. One way to achieve this aim would be through employee training, improved feedback, and a more comprehensive marketing and information strategy. Chinese banks need to provide further for high-end individual clients through consistently developing products and services, especially as they constitute a huge potential market. Fifthly, in terms of information technology, Chinese banks must continue to improve online and mobile banking. Moreover, they can combine digital and traditional marketing to promote products and services. Lastly, but most importantly, Chinese banks need to realize that they are no longer a government institution, but officially service firms. While they need the support and protection of government, in developing capabilities and in managing global rivalry, the ultimate objective is to create competitive and profit-generating firms.

The thesis therefore has a number of perspectives and contributions. From the point of view of theory, it explores the relationship between FDI and institutional factors in shaping the development of Chinese banking, and links these external factors with firm-level strategy the internal evolution of competitive capabilities. From an empirical point of view, the thesis provides new case evidence on Chinese banks, and especially on their development in the key years since 2003. It has furthermore linked their development with theories on firm strategy and competitive capabilities. From a practical point of view, it has produced proposals for the strategy and management of Chinese banks in ownership and governance, product development, client relationships, human resources, training, and information technology.

Appendix 1: Interview Questions

A. Personal Details

1. Could you outline your personal background and career, and your current role and responsibilities in the company?

B. Marketing and Product Development

2. What new products and services has your bank developed in the last ten years, and in what ways do they differ from your previous portfolio?

3. To what extent do ideas for new services and products come from the company headquarters? What, on the other hand, is the involvement of local management in generating new services or products, or adapting headquarters policies to local conditions?

4. How have the marketing and advertising of products and services changed over the last ten years?

5. To what extent are headquarters or local management responsible for the conduct of marketing and advertising?

6. What differentiates your products, services, marketing and advertising from other banks?

C. Customer Relationships and Information Technology

7. How important is the improvement of customer and client relationships in the strategy of the bank?

8. How do you find out what your customers and clients want in terms of products and services?

9. In what ways have customer and client relations been improved for large private firms, small to medium enterprises, VIP or wealth management clients, and retail customers in general?

10. How have you used information technology to improve organisational efficiency and customer services?

11. What plans do you have to develop online banking and mobile banking

D. Human Resources

12. How has the recruitment and training of staff changed at the bank over the last ten years?

13. How and why have promotion and reward systems changed at the bank?

14. Which aspects of human resources remain to be addressed if the bank is to fulfil its strategic objectives?

E. Regulation and Governance

15. To what extent do you believe changes in nature of banking regulation and control in China, in the last ten years, and notably the appointment of the China Banking Regulatory Commission, have transformed the strategy and management of the bank?

16. To what extent and in what ways is the influence of the Hunan provincial government important to the management of the bank and the services provided?

17. To what extent are you aware of the influence of the foreign joint venture partner on the management, products, services, marketing, and human resource policies of the bank? （CCB, BOC, ICBC and CITIC bank only）

18. Have there been significant developments in the decision-making structures, governance and management of the bank, in the last ten years?

19. To what extent, specifically, has the relationship between local management and the headquarters changed, over the last years, and where does authority for both major and operational decisions lie?

Appendix 2: Interviews

CCB

Mr Heng Chang, Tier 2 Branch, Chairman of the Labour Union, 7th November 2012 and 10th July 2013

Ms Juan Yu, Sub Branch, VIP Clients Relationship Manager, 12th July 2013

Mr Li Lin, Sub Branch, Vice Present, 7th November 2012 and 12th July 2013

Mr Liang Gong, Tier 2 Branch, Electronic Banking Department Manager, 10th July 2013

Mr Long Xu, Tier 2 Branch, Corporate Clients Manager, 11thJuly 2013

Mr Shaoming Huang, Tier 2 Branch, Senior Client Relationship Manager, interview, 7th July 2013

Ms Yanmei Xia, Tier 2 Branch, HR Vice Manager, 10th July 2013

BOC

Mr Junping Liu, Tier 2 Branch Vice Present, 15th July 2013

Ms Luo Li, Tier 2 Branch HR Vice Managers, 15th July 2013

Mr Ruoguo Cheng, Tier 2 Branch, Electronic Banking Department Manager, 15th July 2013

Ms Ting Feng, Sub Branch, Small to Medium Enterprise Clients Manager, 16th July 2013

Mr Yun Xie, Sub Branch VIP Client and Individual Customer Manager, 16 July 2013

ICBC

Ms Haojuan Zhang, Sub Branch VIP and Individual Customer Client Relationship Manager, 23rd July 2013

Mr Jiangang Chen, Tier 2 Branch Present, 23rd July 2013

Mr Qin Zeng, Tier 2 Branch, Electronic Banking Department Vice Manager, 23rd July 2013

Mr Xin Xu, Sub Branch, Small to Medium Enterprises Department Manager, 22nd July 2013

Mr Xueming Lu, Tier 2 Branch HR Manager, 24th July 2013

CITIC Bank

Ms Changshun Jiang, Tier 2 Branch HR Vice Manager, 19th July 2013

Mr Guozhong Xie, Tier 2 Branch, Vice Present, 6th November 2012 and 18th July 2013

Mr Heng Zhou, Tier 2 Branch, Vice President, 6th November 2012 and 18th July 2013

Mr Junwei Lei, Tier 2 Branch, Electronic Banking Department Vice Manager, 19th July 2013

Mr Yang Zhao, Tier 2 Branch, Small to Medium Enterprise Manager, 17th July 2013

Ms Yixuan Zhang, Sub Branch, Individual VIP Customer Manager, 17th July 2013

HXBC

Ms Jing Guo, Tier 1 Branch Vice Present, 25th July 2013

Ms Jun Liu, Sub Branch, VIP and Individual Client Relationship Vice Manager, 25th July 2013)

Ms Ping Li, Tier 1 Branch, HR Manager, 26th July 2013

Mr Wei Xiong, Headquarters, Broad of Supervisors, 25th July 2013

Mr Zhiqiang Dong, Tier 1 Branch, Electronic Banking Department Vice Manager, 26th July 2013

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