India and China’s Impact on Global Banking

We hear the stories and see the news and yet, for all we know about India and China’s phenomenal growth story, how much do we really know about Indian and Chinese Banking? Shrouded in secrecy for decades, these state-owned financial behemoths are beginning to stir. In order to continue to fuel economic growth, the governments and regulators of these tiger economies are releasing the chains of their financial markets. What will this release mean to foreign banks and how should overseas banks react?

For the past few years, everyone has been talking about the powerhouse economies of India and China and, more recently, Brazil and Russia. It is not surprising that such discussions became the norm when the next billion consumers will arise out of these economies, with affluence to match those of Americans and Europeans.

The real interest in the BRIC economies – Brazil, Russia, India and China – arose from a Goldman Sachs research report published in October 2003 entitled ‘Dreaming with BRICs: The Path to 2050.’ In this report, researchers at Goldman Sachs forecasted that by 2040 the BRIC economies would have a greater GDP than the G7; would be the main sector of growth for the next 45 years at an average 8% per annum; and that, by 2050, only the USA and Japan would remain in the G6, with the BRICs displacing Germany, the UK, France and Italy from this list of the most powerful countries in the world. The implications for the European Union appear to be grave.

The story of each economy is very different, with Brazil and Russia showing a very different form of growth to that seen in India and China, as illustrated by Figure 1.1. There is a strong relationship between the four economies however, with the ever increasing global expansion of China as a manufacturing economy and India as a services economy placing strong demand for supply of resources from Russia’s oil supplies and Brazil’s natural resources. As a result, increasing demand for goods from China and India is fuelling growth in the Russian and Brazilian economies.

Other factors need to be considered here too. The chart shows that India and China both have much larger populations than Brazil and Russia. India and China’s workers are still heavily engaged in rural and agricultural locations, even with their respective services and manufacturing strengths, compared with Brazil and Russia’s workers who are already heavily employed in service industries. And the really telling numbers are around China and India’s GDP growth which have been running at 7% or greater per annum for the last decade, and are sustainable. Such growth rates for the long term are more questionable in the case of Russia, which has systemic issues of poor health due to alcoholism and drug abuse, alongside a declining population, as can be seen by the negative fertility rates. In fact, President Putin recently introduced financial incentives for women to have more than one child, although it remains to be seen whether such policies are successful.

The Future of Banking

<table>
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<tr>
<th>Country</th>
<th>Brazil</th>
<th>Russia</th>
<th>India</th>
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<td></td>
<td></td>
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</tr>
<tr>
<td>agriculture</td>
<td>20.0%</td>
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<td>60%</td>
<td>49%</td>
<td>0.7%</td>
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<tr>
<td>industry</td>
<td>14.0%</td>
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<td>22%</td>
<td>22.9%</td>
<td>19.1%</td>
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<td>services</td>
<td>66.0%</td>
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<td>23%</td>
<td>29%</td>
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<tr>
<td>Unemployment</td>
<td>9.9%</td>
<td>7.6%</td>
<td>9.9%</td>
<td>4.2% (20%)</td>
<td>5.1%</td>
<td>4.7%</td>
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<tr>
<td>Fertility</td>
<td>1.91</td>
<td>1.28</td>
<td>2.73</td>
<td>1.73</td>
<td>2.09</td>
<td>1.66</td>
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<tr>
<td>(children/woman)</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Population</td>
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<td>1.38%</td>
<td>0.59%</td>
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<tr>
<td>Growth</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Life Expectancy</td>
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<td>64.71</td>
<td>72.58</td>
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<tr>
<td>GDP (purchasing power parity)</td>
<td>$1.556 trillion</td>
<td>$1.589 trillion</td>
<td>$3.611 trillion</td>
<td>$8.859 trillion</td>
<td>$12.36 trillion</td>
<td>$1.83 trillion</td>
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<tr>
<td>GDP (exchange rate)</td>
<td>$619.7 billion</td>
<td>$740.7 billion</td>
<td>$719.8 billion</td>
<td>$2.225 trillion</td>
<td>$12.49 trillion</td>
<td>$2.228 trillion</td>
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<td>GDP real growth rate</td>
<td>2.4%</td>
<td>6.4%</td>
<td>7.6%</td>
<td>9.9%</td>
<td>3.5%</td>
<td>1.8%</td>
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<td>GDP by sector</td>
<td></td>
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<tr>
<td>agriculture</td>
<td>10.0%</td>
<td>5%</td>
<td>20.6%</td>
<td>14.4%</td>
<td>1%</td>
<td>1.1%</td>
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<tr>
<td>industry, Including construction services</td>
<td>39.4%</td>
<td>35%</td>
<td>28.1%</td>
<td>53.1%</td>
<td>20.7%</td>
<td>26%</td>
</tr>
<tr>
<td>services</td>
<td>50.6%</td>
<td>60%</td>
<td>51.4%</td>
<td>32.5%</td>
<td>78.3%</td>
<td>72.9%</td>
</tr>
<tr>
<td>Inflation</td>
<td>5.7%</td>
<td>11%</td>
<td>4.6%</td>
<td>1.9%</td>
<td>3.2%</td>
<td>2.2%</td>
</tr>
</tbody>
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**Figure 1.1** The Economies Compared

For these reasons, the world’s eyes remain upon the two countries with the largest populations and sustainable growth prospects: India and China. And one of the big things holding back these two economies is their banking and financial markets, or lack of them.

**INDIA: SERVICES THE WORLD**

India’s economic success story dates back to the 1980s, when the government began investing in a critical programme of education, focused upon technology and language skills. This educational programme has enabled India’s educated population to become English-speaking programmers and support providers to overseas operators and the good news is that India can keep up this phenomenal growth thanks to a population that is young, educated and growing.

The over one billion people who live in India are replenishing at a rate of 2.73 children per woman – compared to only 1.28 in Russia – with over 130 million new workers joining
the Indian economy during the 2000s: a number equivalent to the workforces of Australia, Canada, Mexico, Poland, South Africa and the United Kingdom combined.\(^2\)

Not only are seven out of 10 people under the age of 36, but they are also increasingly well educated. For the last 20 years, India’s educational programme has achieved a population of 40 million graduate level citizens, 80 million achieving secondary education and nearly 150 million making it through primary education. On the other hand, two out of every five Indian citizens are still illiterate and a third live on less than a dollar a day. The challenge then is to achieve 100% literacy, which is the firm target on the government’s agenda.

For example, successive Indian governments have increased investment in education consistently since the 1950s, with almost 4% of GDP placed into education since the late 1980s. This change of focus is evidenced by the fact that although two-thirds of India’s over 50-year-olds are illiterate, only a quarter of under 18-year-olds are. Therefore, India’s educational reforms and focus upon globalised services has been a significant success factor in their ability to achieve sustainable economic growth.

This is not to say that India relies purely upon services for its success, in that food production represents almost $70 billion of output every year and makes India one of the largest food producing nations in the world just behind China. But India is known for services due to the extraordinary success of their technology and call centre service industries, and it is these industries that can thank the educational and governmental reforms of the 1980s and 1990s.

In retrospect, these reforms were particularly visionary in terms of investment in technology and languages, as the 1990s saw the fuel of growth being delivered through globalised services via the internet. The internet boom allowed for the delivery of remote services which naturally relocated to India due to the cost savings. As a result, India has become the servicing operation to the world, with over three-quarters of global IT sourcing located in the country and most of the world’s most recognised brands locating operations there, including American Express, Microsoft, General Motors, Sony, Coca-Cola, Philips, Wal-Mart, General Electric, Reebok, Boeing, IBM and so on.

The growth of India’s services has been particularly noticeable in the financial community. TowerGroup estimate that total spending on offshore outsourcing amongst the world’s financial institutions is rising from around $1.5 billion in 2004 to almost $4 billion in 2008, with India taking around 40% of that spend, or nearly $2 billion a year from the financial community alone. Nevertheless, financial services is not the only industry India serves, with services exports up by 71% in 2004–05 to $46 billion, of which software services represented $17.2 billion.

All of this is good news for banking, with consumer’s personal disposable income surging 42% between 1999 and 2003, over 15 million credit cards issued, and four out of every five cars sold through loans. But it’s not all good news.

**INDIA’S BANKING: RUN BY CIVIL SERVANTS**

India’s banks have been fairly well protected from reform during this period. This is due to a number of reasons, with the primary reason being the Indian government’s concerns over foreign ownership. Although government controls on foreign trade and investment, have

\(^2\) UK (30 million), Mexico (43 million), Canada (16 million), Australia (10 million), South Africa (15 million) and Poland (17 million).
been reduced in some areas, such as civil aviation, telecom, and construction, most other areas are still subject to high tariffs. These tariffs were running at around 20% on average for non-agricultural items in 2004, and severe limits on foreign direct investment (FDI) are still in place.

In banking terms, these restrictions are potentially constraining India’s competitiveness. 80% of India’s banking system is government owned following nationalisation in 1969 to bring banking to the masses. The recent developments in private sector banks still only have a few names which stand out, such as HDFC Bank and ICICI Bank.

Of particular note is the fact that the central bank, the Reserve Bank of India (RBI), takes an active role in protecting India’s banking system from being open to full competitive forces. For example, RBI recently attempted to restrict the operations of a new PayPal style service set up by the India Times, Wallet365.com, by enforcing Know Your Customer rules. These strict rulings severely hinder the convenience of the service, which is the whole point of providing an online wallet. Equally, RBI forced the new Chief Executive for HSBC India, Naina Lal Kidwai, to relinquish her non-executive directorship at Nestlé because it broke their strict guidelines for corporate governance, even though such guidelines would not apply to a bank executive in other regions.

For foreign banks, RBI’s activities create a major barrier to effective entry. First, there are domestic restrictions such as the requirement that any bank must prioritise that 40% of all loans and advances go into agriculture and small business, the so called ‘priority sectors’, and that 25% of bank branches be located in rural or semi-urban areas which are typically the least profitable. RBI also limits foreign ownership in private sector banks to a maximum 5% although, under government pressure, this may be changing. For example, in March 2006, RBI allowed the first foreign institution to increase its investment in a private sector bank to more than 5%, with Warburg Pincus taking a 10% in Kotak Mahindra Bank.

Without such change India faces significant issues, as the government wants to open financial markets to more foreign ownership in order to increase capital flow. Government representatives have openly discussed financial reforms and want to achieve further liberalisation by 2009. As part of this liberalisation, they recently announced that foreign investment in domestic banks should be able to increase by up to 10% per annum to a maximum 74%. The reason the government needs this to happen is that India has a shortage of capital and capital markets.

The total value of India’s financial assets including bank deposits, equities and debt securities in 2004 amounted to $900 billion. China has five times that capitalisation, with forecasters estimating that China’s stock will achieve $9 trillion by 2010, whilst India will reside at $2 trillion.

The major reason for this constraint is that India’s citizens do not trust banks. The culture of India’s citizens is to trust assets, and so most savings goes into cattle, housing and gold, rather than into banking, deposits and savings. That is why India has the largest consumer economy for gold in the world. India’s people bought $10 billion worth of gold last year, equivalent to double the amount of total foreign investment in India, whilst owning over $200 billion of gold overall, equivalent to about half of the country’s total bank deposits.

It is this trust in physical assets that explains the reason why only 40% of India’s citizens are borrowers or depositors and, as a nation, why India is one of the weakest nations in terms of borrowings. India’s mortgage debt totalled only 2% of GDP in 2002, compared with 8% of GDP in China. Meanwhile, because of the impact of the collapse of Global
India and China’s Impact on Global Banking

Trust Bank (GTB) in 2004, one of the larger private sector banks created during the 1990s, it is unlikely that India’s people will change their minds that quickly about the stability of banks.

This causes India a major dilemma as, on the one hand, the central bank ‘owns’ the government debt and therefore can tell the politicians the way to go forward; on the other, the government needs to maintain economic growth of 8% or more if India’s success story is to continue and this cannot be achieved if markets are artificially controlled and protected from free trade.

The arguments between the central bank and the government, along with the cultural mismatch between India’s citizens and their banks, will need to be resolved if India is to succeed in maintaining momentum.

**INDIA: THE FUTURE IS STILL BRIGHT**

Whilst India wrangles domestically with its own banking services, one of the biggest impacts India will have on world banking will not stem from India’s challenges domestically today, but from its ability to adapt and develop new services tomorrow.

As mentioned, India today controls three-quarters of the world’s IT sourcing. India’s National Association of Software and Service Companies (NASSCOM) states that 80 of the 117 software firms worldwide attaining the highest quality standards for software development are from India. This is substantiated by the fact that the standard by which most technology firms are measured is the Capability Maturity Model (CMM).

CMM has five levels, with the highest level – level 5 – assigned to recognise those firms who optimise software development standards, rather than just using them. Three quarters of the CMM level 5 software centres are in India. This is why India has spawned so many development centres for banking; software solutions firms for bank systems, including iFlex, Infosys and Temenos; and outsourcing and consulting firms in bank services, such as Wipro, Tata and Cognizant.

The result is that India’s IT sector has been growing faster than most other sectors at a CAGR of over 30% since 2000, with India boasting over a quarter of the best IT systems sourcing talent on the planet.

This may all sound fairly pedestrian so far as yes, we all know that India has great success with IT and IT outsourcing. However, we may not all know the likely consequences of this expansion.

For example, many of India’s graduates over the last 15 years have left their homes in Mumbai, Chennai and Delhi to live in Memphis, Charlotte and Detroit. As India’s expatriates have grown in stature and experience, they have been charged with more and more sourcing responsibilities and experience. The result is that many of these executives are more experienced in global sourcing than any others, and are now returning to Mumbai, Chennai and Delhi as repatriates to return their knowledge to their home base. This is a natural move for many, as India’s wealth and quality of living increases to match the expectations for living standards which these executives hoped to achieve when moving overseas in the first instance.

The extrapolation of this movement is that, in around 15 years, India will be teaching the world the management of operations. Some see this as an extreme but the logic is based firmly upon a similar revolution in management techniques seen during the 1950s when the Total Quality Management (TQM) and Just-In-Time Processing (JIT)
revolution came out of Japan. That revolution was created by Dr William Edwards Deming.

Dr Deming was invited to Japan at the end of Second World War to advise Japanese leaders as to how to rebuild Japan’s manufacturing capabilities and methods of production. Dr Deming, a statistician, introduced a range of techniques, including quality processes and JIT, which delivered high quality manufacturing over a period of years and was known as ‘Deming’s 14 Point Plan’. Deming’s Plan has been the foundation of Japanese economic success ever since as Japan not only listened to Dr Deming’s plan, but regimentally adopted it. By the 1970s, Japan was not just producing good quality products from cameras to cars, but with minimal stock and inventory control. The improvements in efficiency soon fuelled an economic boom that lasted 20 years and led to Japan becoming the world’s second largest economy behind America.

This is the phenomenon that many see occurring in India today. Just as Dr Deming created a manufacturing revolution in Japan, global sourcing is creating a management revolution in India.

This revolution follows a number of phases, some of which were outlined earlier in this chapter, which lead to a natural conclusion.

The first phase is a cultural revolution inspired by government educational reform policies during the 1980s to make India become a global competitor.

The second phase is a global revolution as corporations relocate operations globally through new technological changes. The result is that India becomes the leading centre for systems developments, services and operations.

The third phase involves learning how to integrate the competencies of sourcing across financial operations. There are three distinct competencies involved:

(a) how to source – insource, cosource or outsource – a combination referred to as right-sourcing;
(b) where to source – locally, nationally, internationally, nearshore, onshore or offshore; and
(c) when to source – front office, back office, commodity, strategy, product, service, channel.

The decisions involved in deconstructing bank processes and then reconstructing them back together again in a seamlessly integrated global structure is the demanding role of today’s sourcing leaders. The combination of skills required is generally referred to as ‘smart-sourcing’, and smart-sourcing has become critical to bank operations: how, where and when to source. And who are the world’s experts in smart-sourcing? The leading proponents with these skills are Indian.

The fourth phase therefore is to use this experience and leadership to innovate the management and leadership of banking. This is India’s potential – to reinvent banking based upon leadership in global sourcing techniques – and, regardless of India’s domestic banking structure, is the likely major conclusion from India’s IT services operations over the next decade. Should India decide to leverage that leadership domestically however, as in to use the repatriated skills returning to the country over the next 10 years, then that experience could be used to enable India’s banks to become the world’s most competitive banks.

The strategy for India – whether to export skills for bank structures or retain the leadership internally – will be one of the most fascinating aspects of India’s developments in financial services over the next decade.
THE RISE OF CHINA

Further to reviewing India’s capabilities, which lay mainly with smart sourcing technology services rather than banking, let us look at China’s rise to prosperity.

China’s economic prosperity is largely due to the major government reform programme of Deng Xiaoping during the 1980s. Xiaoping’s vision moved China away from centralised planning and control, closed to international trade, into a thriving market-oriented economy. His government achieved this by liberalising prices, decentralising fiscal policies to local government, and increasingly allowing State-Owned Enterprises (SOEs) to act autonomously.

Xiaoping’s reforms were continued through the 1990s by his successor Jiang Zemin and were paid homage to in a recent speech by the current Chinese President, Hu Jintao, who stated ‘from 1978 to 2003, China’s GDP increased from US$147.3 billion to over US$1.4 trillion, with an average annual increase rate of 9.4%; its total foreign trade volume grew from US$20.6 billion to US$851.2 billion, with an average annual growth rate of 16.1%; and the poverty-stricken population in the rural area dropped from 250 million to about 29 million’.

Between 2003 and 2005, China’s economy grew at 9% per annum, and has more than doubled in the last 10 years with industrial output increasing by a factor of nine since 1978.

Again, a key aspect of China’s growth has been through targeted education, with China producing over 800,000 science and engineering graduates in 2005, more than any other nation, and expecting to rise to over a million science and engineering graduates by 2010, more than the total number of graduates in these disciplines leaving all American, Japanese, French, German and British universities.

This will continue to fuel China’s manufacturing prowess and is critical to China’s future growth plans as, unlike India, China has a big challenge in that its’ population is getting older. As discussed earlier in this chapter, India has a rapidly growing population with 70% of the population under the age of 36. Conversely, China has a declining population. This is largely due to the Planned Birth Policy introduced by Deng Xiaoping’s administration in 1979. The Policy was designed to cope with the demands of a society with scarce resources and encouraged families to only have one-child. Two decades later, the result is that 300 million Chinese who would have been born do not exist. To put this in perspective, India has 130 million new citizens joining their society in the 2000s, while China has 300 million missing.

That is why China’s population growth lies at a measly 0.59% – India’s is 1.3% – and why China, like much of Japan, Europe and other parts of the world, has one of the most rapidly ageing populations in the world. China will have to look hard for future workers to continue to sustain their growth phenomenon. That is not difficult though, when unofficial figures estimate that China has almost 260 million unemployed people, about the population of the USA.

China’s real issues lie elsewhere, including how to manage pollution and energy supply, converting State-Owned Enterprises (SOEs) from nationalised to privatised industries, and how to rebalance the poor rural populations in the West with the growing affluent urban populations of the East. All of these relate back to China’s banking structures, or lack of them.

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Many of China’s issues in restructuring to support their economic powerhouse status relate to their financial systems. For example, China currently has foreign currency reserves of almost a trillion dollars, growing at over $17 billion a month. As a result China’s central bank, the People’s Bank of China, regularly buys dollars from their commercial banks and substitutes them for Renminbi bonds. With so much money in government hands, is it any wonder that China is spending so grandly on major projects such as the Qinghai Tibet railway. The railroad is the world’s highest, and the final section to Lhasa was opened on 2 July 2006 at a cost of $4.2 billion. China has invested over $125 billion in the Western provinces since 2000, including the controversial three gorges dam projects, and has $21 billion more planned. All of these investments are part of the rebalancing of wealth and commerce between East and West China.

Dealing with the fact that China is swimming in excess dollars is one challenge, but China’s banking has more fundamental issues. For example, until 2001, the banks were wholly owned by China’s government and had no function other than to take monies from China’s citizens to invest in government projects and enterprises. That is why China’s banks had little concept of customer services or of managing risk. If you entered a Chinese bank branch, the whole ethos is one of directing customers into queues and then leaving the customer to wonder whether they would ever get served. Interest rates on savings averaged just 0.5% for the last 10 years, even though China’s citizens save almost of a quarter of their earnings.

On the other hand, China’s bank lending was virtually blind, as long as it was authorised by the People’s Party, with 95% of corporate loans made to State Owned Enterprises (SOEs). That lending has also been China’s banks undoing however as, again according to unofficial reports, China’s banks are suffering from around 40% of non-performing loans, the highest in the region. In other words, four out of ten loans are never paid off but with a trillion dollars in foreign currency reserves available from the government to bail out any bank that gets into problems, it may imply that the issue is covered, but it does lead to some major questions around China’s future.

First, the government is actively trying to shift from the majority of workers being employed by SOEs to a more commercial and competitive economy. Some of these SOEs have already been transformed, such as the car industry, and many are employed in building and construction, with 40 airports, 26 underground railways, 30 nuclear power stations and over 50,000 miles of motorway being built over the next five years.

However, a third of the SOEs are non-performing and should be closed down or sold off. This would lead to a further 150 million people being laid off, and the pay-offs incurred would increase the non-performing loan rate, which is already running at almost a trillion dollars – the same amount as China’s currency reserves. Of more concern is the fact that if China’s banks begin to behave as banks in other parts of the world behave, then it could cause much more civil unrest and destabilise the economy.

Equally China’s banks have already had to be bailed out by the government through recapitalisation of their balance sheets. Since the late 1990s, the Chinese Government has added over $215 billion to their banks reserves in order to keep them afloat. This means that Chinese banks have to generate at least $25 billion more in annual revenues to service the cost of those government borrowings, than equivalent banks would have to generate in other countries.
Second, China’s financial markets have no defined capital markets or commercial banking. China’s capital markets purely fund SOEs, with companies unable to borrow from the bond markets and no recognised equities markets. According to McKinsey, China only raises a third of their capital through the equities markets and, even then, half of that funding goes into government enterprises. That means that only 17% of commercial firms trade on the equities markets, compared to 60% in other emerging economies.

Even more telling is that the corporate bond market is virtually non-existent. The corporate bond market is just 13% of GDP, compared to over half in other emerging markets. Those bonds once again are funding government enterprises. This means that the funding of real business is through generic loans, with 95% of borrowing by commercial firms through bank loans.

The net result is that McKinsey estimates that China could:

• reduce their cost of capital by $14 billion a year through creating a vibrant bond market;
• that more efficient equities markets would reduce the costs of share issuing and trading by over $1.5 billion a year, even at today’s small volumes; and
• that China would realise over $320 billion a year in savings through improvements from financial reform, equivalent to a 17% increase in GDP.

This is part of the reason why, unlike India, China has entered a radical reform programme of their banking operations, which began with World Trade Organisation (WTO) requirements to change in 2001.

CHINA’S BANKING: REFORMING THROUGH 2007

China joined the WTO in 2001 and made a number of concessions, not the least of which was to open their banking markets to direct foreign competition. The process allowed increasing foreign direct investment in China’s domestic banks from 2001, with full competition from 2007. This is different to the Indian markets, as China is completely releasing the handles on their financial institutions once deregulation is complete, whilst India still has highly protective barriers to foreign competition.

Initially, the restrictions on foreign investment in Chinese banks was that foreign ownership could not exceed 25% of a bank and no single investor could own more than 19.9%. These restrictions will gradually be lifted and, as a result, many firms are taking the opportunity to grab a slice of Chinese banking, as illustrated in Figure 1.2.

These firms are taking a calculated risk however.

On the one hand, foreign bank investors in Chinese banking are desirous of the prospects of creating a new capital market and equities exchange as a third major business hub to match those of London for Europe and New York for the USA. They are also avaricious for the country’s growing ‘consumer class’ which numbered almost a quarter of a billion people in 2002, or 19% of the population. These are consumers who previously could not invest overseas, did not have access to high net returns and are potentially eager for European and American banking style services.

On the other hand, China’s banks are still unstable, without a strong understanding of customer service or risk management, as previously mentioned. As foreign banks enter into Chinese banking, they do run the risk that their non-performing loans are with State-Owned
Enterprises (SOEs), in other words with the government. If overseas banks begin to apply strong credit risk management techniques the result will be that they will stop providing and servicing loans to SOEs and will begin to call them in. Meanwhile, the very same banks are also likely to begin creating financial instruments that divert consumers’ investments away from China’s SOEs and into commercial banking or, even worse, overseas products. Either approach would cause the People’s Party to rethink the reform process and potentially close down some of these ‘joint ventures’ with the overseas player. In so doing, the overseas investors will kiss their investments goodbye.

Nevertheless, the rewards outweigh the risks according to most bank investors and so the re-energising of Chinese banking will continue. During this renovation, a new form of banking will also appear which will teach Europe’s and America’s banks a few lessons.

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<th>Seller</th>
<th>Deal Structure</th>
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<tbody>
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<td>Bank of America (US)</td>
<td>China Construction Bank</td>
<td>9% stake to rise to 19.9% in 4 years</td>
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<td>Bank for Nova Scotia (Canada)</td>
<td>Xian City Commercial Bank</td>
<td>5% to rise to 24.9% in 4 years</td>
</tr>
<tr>
<td>Citigroup (US)</td>
<td>Shanghai Pudong Development Bank</td>
<td>5% stake</td>
</tr>
<tr>
<td>Commonwealth Bank (Australia)</td>
<td>Jinan City Commercial Bank</td>
<td>Agreement for 11% stake</td>
</tr>
<tr>
<td>Deutsche Bank (Germany)</td>
<td>Huaxia Bank</td>
<td>9.9% stake</td>
</tr>
<tr>
<td>Hang Seng Bank (Hong Kong)</td>
<td>Industrial and Commercial Bank of China</td>
<td>15.98% stake</td>
</tr>
<tr>
<td>HSBC (UK)</td>
<td>Bank of Communications</td>
<td>19.9% stake</td>
</tr>
<tr>
<td>ING (Netherlands)</td>
<td>Bank of Beijing</td>
<td>19.9% stake</td>
</tr>
<tr>
<td>Merrill Lynch (US)</td>
<td>Huaan Securities Co.</td>
<td>33% stake</td>
</tr>
<tr>
<td>Newbridge Capital, Inc. (US)</td>
<td>Shenzhen Development Bank</td>
<td>17.9% stake</td>
</tr>
<tr>
<td>Royal Bank of Scotland (UK)</td>
<td>Bank of China</td>
<td>10% stake</td>
</tr>
<tr>
<td>Standard Chartered (UK)</td>
<td>Bohai Bank</td>
<td>19.9% stake</td>
</tr>
</tbody>
</table>

Figure 1.2    Foreign Banks’ Direct Investments in China’s Banks by Buyer (2004–05)

LESSONS TO BE LEARNT FROM CHINA’S BANKS

The biggest lesson European and American banks will learn from China is in technology. Just as America has been the technology powerhouse of the world for the last half a century, China intends to be the world’s technology powerhouse for the next. That is why you cannot buy any electronic goods these days without a ‘made in China’ label somewhere on the product, whether it be a Lenovo PC or a Konka TV. But China’s real focus is to own the next generation of technologies, and the People’s Party is investing very heavily in new areas from next generation internet to next generation mobile. For example, in 2006, China
India and China’s Impact on Global Banking

had 400 million mobile telephone users and 110 million internet users, over 60 million of those on broadband. This is why China is revolutionising services and products dramatically and with full government backing.

The government is also backing these changes because the last century of technology innovation bypassed China. By way of illustration, when the foundations of the internet were being laid in the 1980’s, the USA created the network and dominated the system. That is why each American on average owns six IP (Internet Protocol) addresses, compared with 26 Chinese having to share one IP address, according to the International Telecommunication Union.

So China is pouring dollars into technology, and big dollars. For example, IPv6 – Internet Protocol version 6 – is the chosen standard for the next generation of the internet. The Chinese government created a project that ran from the end of 2002 until August 2003 called the China Next Generation Internet, which aimed to champion China’s leadership in this area. The project was supported by the National Development and Reform Commission, the Ministry of Science and Technology, the Ministry of Education and other leading government ministries, and received over $75 million investment. This gave the Chinese community a clear understanding of the implications and opportunities for IPv6. Similarly, the government lends support to leading technology providers, such as Huawei which provides internet networking facilities, and provides grants to business to experiment with new technologies.

It is not surprising that this is critical to China’s future when you have a business that has jumped from 10% of the world’s electronics production to 18% between 2000 and 2003 at a CAGR of 15.4% and is now worth over $200 billion a year. Similarly, China will have the world’s largest broadband enabled population, with 140 million citizens on high speed lines expected by 2010.

The result is that Chinese banks are reaping the rewards of this spend. According to TowerGroup Research, bank IT spending in China increased 32% annually from 2004 to 2007, rising from $10.1 billion to $23.2 billion (USD), which is faster than anywhere else in the world. This spend is going into new core systems and into new technologies such as WiMAX, the next generation wireless standard, IPv6 and fourth generation mobile telecommunications.

One illustration of this leadership in technology was the give-away Swatch-style World Cup 2006 watch from Chinatrust Commercial Bank during the summer. The watch was given away to promote the soccer World Cup in Germany, and incorporated a contactless MasterCard PayPass chip. The idea being that you could walk around Beijing and when you saw a CD or DVD you wanted, you just flashed the watch over the reader and the product was purchased. Simple, innovative and far and away ahead of anything Western European or American banks are doing with these RFID chips so far. The watch is discussed in depth in Chapter 15, and illustrated in Figure 15.2 if you want to have a look at this sort of innovation in more depth.

The key to China is their technology future therefore. Just as America was synonymous with computing and innovation in the 20th Century, China will be the technology powerhouse in the 21st Century. Just as Wang, Data General, Prime, Digital and all the other East Coast computer firms were subsumed by the rise of Intel and Microsoft in the 1990s; Dell, Intel, HP and others will be seriously challenged by the rise of Lenovo and Huawei in the 2000s. Therefore, as a banker, if you want to see the next generation of channels, technologies and innovation: go to China.
CONCLUSION: CHINA AND INDIA ARE TWO TIGERS YOU CANNOT IGNORE

Throughout this chapter we have looked at China and India in depth, and compared and contrasted the two countries. From a banking viewpoint, both countries offer exciting opportunities as they have been closed to foreign bank entry until recently.

Neither country has sophisticated capital markets or commercial banking, and retail bank lending, savings and deposits are also relatively untapped. There are major differences, however.

India’s banking systems are more cosmopolitan with some capabilities for commercial lending and equities. This could be leveraged if it were not for the concerns of India’s central bank that India’s banks, if opened to foreign competition, do not know how to compete. As a result, India’s reform process is very slow.

China, on the other hand, has been forced to change fast as part of their accession to the WTO. Therefore, the banking markets are revolutionising with investment and foreign skills. China, in the short term therefore, will be the major market to watch.

In the long term, it is different.

China, in the long term, will be teaching American and European banks how to use technology, but their markets will gradually dwindle and wane as their citizens grow old. Conversely, India has 7 out of 10 citizens under the age of 36. Therefore, whilst China teaches the world about the next generations of technology, India will be producing the next generations of managers.

This book is called ‘The Future of Banking: In a Globalised World’, and you may be wondering what the vision will be for the future therefore. Well, by 2020, some are jokingly referring to the idea of a London centre being the outsourced trading operations for India’s banks whilst New York provides the offshore clearing and settlement systems for Beijing.

You never know, it just might come true.