

# **Regulatory Reform and Convergence in Banking: The Case of China**

Author: Brau, J.C., Dahl, D., Zhang, H. and  
Zhou, M.

Discussant: **Ana Lozano-Vivas**

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# ISSUES ADDRESSED

- **Main purpose:** To analyse the effect of regulatory reform on the asset allocation and capitalization of Chinese banks .
- 2002-2007, China's entry into the World Trade Organization, WTO (2001, reduce restrictions on acquisitions and permitted greater freedom of operational and geographical scope).
- Activity convergence: asset allocation; Financial structure: capitalization
- Type of banks: Big four, Majority state, Majority private, Majority foreign.

# Methodology

- **Methodology:** To assess activity and financial level convergence of different types of banks in China by using a standard partial adjustment model.
- **Issues:**
  - (i) How regulatory reforms have minimized inequalities among types of banks in China → they use the time period 2002-2006;
  - (ii) To identify convergence they define common target ratio within type of banks and for all banks, i.e. grand mean ratio.

# Sample and variables

**Sample:** A panel data of 427 Chinese banks over the period 2002-2006 (Big four banks; Majority state banks (25); Majority private (87); Majority foreign (10)) → **unbalanced panel data**

## **Variables:**

**Depend variable:** Total net loans/total assets; Total equity capital/total assets.

**Explicative variables:** Target ratio and lag of the depend variable, type of bank.

# Results

- Big four, majority state, majority private, and majority foreign categories do not have a common targeted levels of loans and capital in relation to assets.
- Domestic banks exhibit convergence in behaviour toward each other but remain distinct from majority foreign banks → Although Chinese banking is segmented after WTO, however a more uniform pattern emerged in domestic ones.

# **Comments and suggestions**

**(1) The propose of the paper.**

**(2) Methodology used.**

**(3) Literature review used as framework.**

**(4) General comments.**

# Comments and suggestions: The propose of the paper

Goal: To insolate the impact of **regulatory** reform on **convergence** in Chinese banking industry.

- (1) **The impact of regulatory reform**: Here I have one question; How do the authors insolate the impact of regulatory reform? →extend the time period of the sample.
- (2) **Convergence issue**: This is based on one banking activity, i.e. loans and one measure of banking financial structure, i.e. capitalization.

However, WTO is leaded to reduce restrictions on acquisitions, so it seems that it is more related with ownership of the banks→It should be more appropriated to look for the convergence on all banking activities of the balance-sheet (asset allocation) and every items of the banking financial structure.

# Comments and suggestions: Methodology used

**Methodology**: Standard partial adjustment model in order to know the level of convergence of different types of banks.

- (1) This type of model requires to define common target ratios: This study define a common target ratio for all banks in each category of banks and in the whole industry over time.
  - I. Why does not define an incomplete (partial) adjustment by defining the target within each time period in order to know more accurately the pattern of the convergence? This way should help you to really know the speed effect of deregulation.
  - II. Moreover, partial adjustment implies that “things can not adjust instantaneously.....”
- (2) The target ratio seems to me the actual target since it is defined from the data. What about optimal target rates? → Expected effect of deregulation.



# **Comments and suggestions: Methodology used (Cont.)**

- (3) Usually, in the relevant literature the target ratio are explained by a vector of firm characteristics over time in order to allow the possibility that target ratios differ across firms or over time (For instance, Flannery and Rangan, 2006).**
  
- (4) The authors use the same methodology that Dahl, et al. (2008, JBF) replacing country by type of banks. The economic meaning of the normalization used it is interesting to be motivated → Distance measure (share).**

# Comments and suggestions: Literature review used as framework

- (1) Structure/conduct/performance → Structure is identified with type of banks (Structure in the S-C-P literature is related with the concentration level of the industry).
- (2) Competition → Saviotii and Pyka (2008): Classical and Schumpeterian competition, optimal mix).

# Comments and suggestions:

## General comments

(1) Unbalance panel data:

I. Data constraints?

II. Movement of banks from one group to another?

(2) Majority foreign → Subsidiaries/branches.