Journal of Banking & Finance 37 (2013) 3364–3372

Contents lists available at SciVerse ScienceDirect

Journal of Banking & Finance

journal homepage: www.elsevier.com/locate/jbf

Bank ownership, privatization, and performance: Evidence from a transition country

Chunxia Jiang [a,*], Shujie Yao [b,c], Genfu Feng [c]

[a] Middlesex University Business School, Hendon Campus, The Burroughs, London NW4 4BT, UK
[b] School of Contemporary Chinese Studies, University of Nottingham, Nottingham NG8 1BB, UK
[c] School of Economics & Finance, Xi'an Jiaotong University, Xianning West Road, Xi'an 710049, China

ARTICLE INFO

Article history:
Received 14 September 2012
Accepted 5 May 2013
Available online 14 May 2013

JEL classification:
G21
G28
C30

Keywords:
Bank performance
Privatization
Minority foreign ownership
Efficiency

ABSTRACT

This paper combines the static effect of ownership and the dynamic effect of privatization on bank performance in China over 1995–2010, reporting a significantly higher performance by private intermediaries – joint stock commercial banks and city commercial banks – relative to state-owned commercial banks. However, publicly traded banks, subject to multiple monitoring and vetting in capital markets, perform better regardless of ownership status. The privatization of banks has improved performance with respect to revenue inflow and efficiency gains in the short- or long-run (initial public offerings). The positive long-run effect is more relevant and significant for banking institutions with minority foreign ownership. Moreover, this paper innovatively estimates interest income efficiency and non-interest income efficiency at the same time. The results suggest that Chinese banks are much more efficient in generating interest income than raising non-interest revenue, although the latter aspect has improved significantly during the sample period.

© 2013 Elsevier B.V. All rights reserved.

1. Introduction

China, one of the fastest growing countries in transition, is leaping from its socialist past to its current market-oriented environment. In fact, much of the double-digit type growth experience in China was achieved without a modern banking system in place. Starting only in 2005, the largest Chinese banks entered the capital markets shattering the previous market capitalization records for financial intermediaries in the initial offering markets, making China home to four of the world's 10 biggest banks by market capitalization. This nevertheless gives rise to an interesting research question: what are the main driving forces for Chinese banks' rapid catching up in performance?

To improve bank efficiency and pave the way to a modern banking system, the central government commenced more radical reforms since the end of the 1990s. The first step was to recapitalize the largest state-owned commercial banks (SOCBs) and billions of dollars were injected while eliminating non-performing loans (NPLs) from their books.[1] Subsequently, SOCBs were partially privatized via attracting foreign investors and going public strategies. Foreign investors reacted positively by acquiring minority stakes in all types of banks and the capital market investors also reacted to these bank initial public offerings (IPOs) positively. Successful IPOs and their subsequent extraordinary performance in stock markets provided a sound cornerstone for the overall success of China's further banking reform. These key reforms were along with structural deregulation and prudential re-regulation processes. For example, China's accession to the World Trade Organization (WTO) in 2001 accelerated the opening up process of its banking market to foreign competitors, and the launch of the China Banking Regulatory Commission (CBRC) in 2003 marked a change in the regulatory environment towards a more prudential regulation regime.

* Corresponding author. Tel.: +44 (0) 20 8411 5874.
E-mail address: c.jiang@mdx.ac.uk (C. Jiang).

[1] The central government injected $32.6 billion (CNY 270 billion) capital into SOCBs in 1998 and stripped off their NPLs by $169 billion (CNY 1.4 trillion) in 1999. China's accession to the World Trade Organisation in 2001 has accelerated banking reforms even further. The government injected $45 billion into Bank of China (BOC) and China Construction Bank Corporation (CCBC) in 2003 (each received $22.5 billion), $15 billion into Industrial and Commercial Bank of China (ICBC) in 2005, and $19 billion into Agricultural Bank of China (ABC) in 2009.

0378-4266/$ - see front matter © 2013 Elsevier B.V. All rights reserved.
http://dx.doi.org/10.1016/j.jbankfin.2013.05.009

This paper attempts to address the proposed research question by answering the following specific questions thereby providing information for policy makers regarding further reform of the Chinese banking system: Does bank ownership structure matter? How have privatization strategies affected bank performance? What impacts have China's WTO accession and regulatory changes had on bank performance?

The paper makes a number of contributions to the literature. Firstly, it investigates the effects of reforms on bank performance, enriching the literature from the perspective of transitional as well as developing countries. In particular, it focuses on the static effect of ownership and the dynamic effect of privatization on bank efficiency and goes beyond the findings and explanations of the existing literature (e.g., Berger et al., 2009, 2010). It should be noted that China has adopted a gradual reform approach, which is different from banking reforms in other transition economies in Central and Eastern Europe where foreign banks played a vital role, and in the former Soviet Union block where a "sudden death" approach prevailed by creating new banking systems. Experiences and lessons from China will be of particular interest to policy makers in other developing countries, e.g., Vietnam, Cambodia, Bolivia, Angola and to some extent Malawi that have similarities to the "Chinese Model" when implementing new economic and financial reforms in recent decades.

Secondly, this study breaks down profit efficiency by innovatively estimating interest income efficiency and non-interest income efficiency. Modern banks have increasingly engaged in more profitable fee related activities while diversifying income sources to minimize unsystematic risks. More detailed efficiency analysis on different income generating activities is complimentary to cost efficiency and profit efficiency analysis. Findings will be more informative and relevant to both policy makers and practitioners.

Finally, the paper also makes advances in methodological terms. It addresses the exogeneity problem of input prices when estimating cost (profit) efficiency – an overlooked methodological issue in the literature. Most efficiency studies use endogenously determined bank-specific input prices,[2] which is in contradiction with the assumption of the cost (profit) function that firms face exogenous input prices in competitive factor markets. Poor measurement of explanatory variables could substantially distort efficiency estimates (Green, 1993), which is empirically supported by Mountain and Thomas (1999). However, so far, only a few studies use market average input prices, starting from DeYoung and Hasan (1998), to Berger and Mester (2003), Patti and Hardy (2005), Bos and Kool (2006), and Koetter (2006). Of course, the choice of input prices would not matter if bank-specific and market average input prices provide similar cost (profit) efficiency estimates. But if they do not yield similar results, the measurement of input prices can influence the interpretations of bank efficiency studies. So far, only Koetter (2006) and Mountain and Thomas (1999) investigate the potential impact of misspecification of input prices in Germany and the US. This study enriches this rather thin strand of literature by estimating bank efficiencies using both bank-specific and market average input prices to probe whether, if any, how the alternative measurement of input prices affect efficiency estimates.[3]

Combining the static effect of ownership and the dynamic effect of privatization[4] on bank performance in China over 1995–2010, this paper reports a significantly higher performance by private intermediaries – joint stock commercial banks and city commercial banks – relative to state-owned commercial banks. Publicly traded banks operating in capital markets subject to multiple monitoring and vetting are more efficient regardless of the nature of owners. Chinese banks' non-interest income efficiency level is rather low, compared with cost efficiency, profit efficiency and interest income efficiency. We find that the privatization of banks has improved performance: attracting foreign investors strategy has improved bank efficiency in the long-run, partly due to the transfer of new technology and know-how in financial intermediation; and IPOs strategy has delivered immediate efficiency gains but at a diminishing pace in the long-run. Moreover, China's WTO entry has brought about bank efficiency losses perhaps due to more prudent regulation, while changes in regulatory environment seem to have helped banks improve profitability.

The rest of this paper proceeds as follows. Section 2 reviews literature on bank efficiency. Section 3 discusses research methodologies. Section 4 analyzes empirical results, and section 5 concludes.

2. Literature review

During the last decade or so research interests in bank efficiency have extended to developing and transitional economies. Bank ownership and governance structure are two important and well-explored topics of study. In these centrally planned economies, state ownership of banks was pervasive and banks usually dominated the financial sectors but played a very limited economic role. It is believed that governments could channel funds to sectors (projects) with low financial returns but high social benefits. Governments could act "benevolently" when there is a desire to promote industrialization and development but lack of sufficient private (venture) capital to finance growth. Therefore, state ownership is economically efficient by balancing social and economic objectives (Megginson, 2005).

On the other hand, state ownership is argued to be inherently inefficient. Firstly, the agent-principal problem becomes more prominent under state ownership. When there is a separation between ownership and management controls, managers (agents) may pursue their own interests rather than acting in the best interest of owners (principals) (Bearle and Means, 1932), which may result in negative effects on performance. Secondly, the free-rider problem also becomes more common. State ownership theoretically means that all citizens are co-owners who in practice have no power and incentive to influence and monitor the management of state banks, leaving governments as the only effective representative (Huibers, 2005). Governments, however, have multiple (often conflicting) goals. Thirdly, soft-budget constraints faced by state banks may induce moral hazard problems leading to poor performance. State banks act as government agents to finance state-owned enterprises (SOEs) based on political preference rather than commercial considerations. When banks are in difficulties, they expect help from governments. Therefore, managers of state banks have little incentive to minimize costs or maximize profit. Finally, other reasons also explain poor performance of state banks, including the general view of "too big (important) to fail", the "quiet life" hypothesis, poor monitoring and lack of market discipline (Megginson, 2005).

Empirical research generally documents negative impacts of state ownership. Some studies (e.g., Bonin et al., 2005a; Fries and Taci, 2005; Yao et al., 2007) find under-performance of state-owned banks compared with their private counterparts. La Porta et al., (2002) argue that politicians may use government-owned banks to further their own political goals leading to lower subsequent economic growth, and Dinc, (2005) provides evidence of

[2] It is derived from dividing total factor expenses by the total units of factors employed.

[3] Employing a one-step stochastic frontier approach (SFA), the paper reveals that the use of bank-specific input prices tends to overestimate cost efficiency while underestimating profit efficiency.

[4] The static ownership effect examines whether banks' performance varies with different ownership structures, while the dynamic effect reveals the short-term and long-term influences of privatization strategies on bank efficiency.

Download English Version:

https://daneshyari.com/en/article/5089532

Download Persian Version:

https://daneshyari.com/article/5089532

Daneshyari.com