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# Determinants of financial performance in Chinese banking

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Pages 1585-1600 | Published online: 21 Sep 2010

Cite this article <https://doi.org/10.1080/09603107.2010.505553>

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are significant with the expected signs. Though the type of bank is influential, bank size is not. Neither the percentage of foreign ownership nor bank listings has a discernable effect.

## Notes

<sup>1</sup> The Central Bank Law and the Commercial Bank Law.

<sup>2</sup> The equity participation of a single overseas financial institution in Chinese banks cannot exceed 20%. Source: CBRC ([2003](#)).

<sup>3</sup> Prior to these changes, the big four state-owned banks had high percentages of Nonperformance Loans (NPLs) stemming largely from loans made to state-owned enterprises. In 1997, they were re-capitalized via the issue of special government bonds (CNY270 bn or \$32.5 bn), and their NPLs were transferred to four asset management companies. \$60 bn drawn from foreign exchange reserves were injected into three of the big four. The Bank of China and China Construction Bank each received \$22.5 bn in 2003; \$15 bn went to the Industrial and Commercial Bank of China in 2005. For more detail on bank reforms, see Berger et al. ([2009](#)) and Fu and Heffernan ([2009](#)).

<sup>4</sup> The NFW... State Council, the NFW... nal Develop... Bank of China (P... ces and municipa... omic period - usually... e big four bank...



<sup>5</sup> Bonacc... c banks outperfo...

<sup>6</sup> The big... s (out of 113 at the en...

<sup>7</sup> The thi... ectives (e.g. infrastructure) and unlike the other banks are not expected to maximize profits. They

are funded via the PBC and state bond issues.

<sup>8</sup> As reported in the Economist ([1992](#)).

<sup>9</sup> Weaver ([2001](#)) reports a response rate of 40%, or 29 firms.

<sup>10</sup> It is notable that no study in the management accounting literature adjusts for factor inputs. In the banking literature, only Fiordelisi ([2007](#)) standardizes EVA by capital invested.

<sup>11</sup> The CI rating in terms of domestic strength is applied here.

<sup>12</sup> The average long-term government bond yield is not available between 1999 and 2000. Since there were no changes in either the central bank or financial institution base rates between 1999 and 2001, this study used the 2001 average long-term government bond yield for these 2 years.

<sup>13</sup> Arellano and Bond ([1991](#)), Arellano and Bover ([1995](#)), Bond ([2002](#)), Baltagi ([2005](#)) and Baum ([2006](#)).

<sup>14</sup> Once lagged variables are introduced, the sample is reduced from 76 to 70 banks over 7 years (2000–2006), hence posing, potentially, a ‘large N, small T’ problem. Fixed individual effects could include the sample of banks sharing some time-invariant factors

such as present among the city Autocorr profitability correlate might varia be cruci

may be differences sample, only s overseas. d with past ally (ts, etc.) dependent process may

<sup>15</sup> The li otherwise generate ROAA or Hansen test statistics almost the same at 0.12 and 0.101 but the signs on the lagged



ROAE coefficients are counter-intuitive: positive for ROAE lagged by 1 year, but negative when lagged by 2 years. On this basis, we proceed with the one lag model.

<sup>16</sup> Arellano-Bond tests for Autoregression AR(1) and AR(2) in first differences. The test for no second-order serial correlation of the disturbances of the first-differenced equation is important for the consistency of the GMM estimator. In addition, the Hansen (1982) J test for the joint validity of the moment conditions (the presence of over-identification) is crucial to the validity of GMM estimates.

<sup>17</sup> The listed banks include the Industrial and Commercial Bank of China, Bank of China Limited, China Construction Bank Corporation, China Merchants Bank Co. Ltd., China, Minsheng Banking Corporation, Shanghai Pudong Development Bank, Hua Xia Bank and Shenzhen Development Bank Co. Ltd.

<sup>18</sup> Out of a possible 113 city banks at the end of 2006.

<sup>19</sup> Even by the end of 2006, only a selected number (3) were allowed to offer CNY denominated services and/or establish a limited number of branches. They continue to complain of discrimination.

<sup>20</sup> No data are available for urban credit unions; there are some data for just two rural coop banks (out of 80) and three rural credit unions (out of 19 348). They provide very basic banking services to local members. Based on surveys conducted in 2006, the rural coops (CNY22.0 billion) are the city of China's Finance

<sup>21</sup> Roughly three of these banks, but was confined to 1999, it has been banks. According to was re-classified

<sup>22</sup> Since allowed to have been

<sup>23</sup> Source



<sup>24</sup> Other banks have even lower net fee income ratio due to fewer branch networks (Wang, [2006](#)).

<sup>25</sup> The independent variables are selected based on findings from previous studies (e.g. Goddard et al., [2004](#); Kosmidou et al., [2004](#); Valverde and Fernández, [2007](#); Athanasoglou et al., [2008](#) and etc.). Data availability also constrained some of the variable choices. For example, had it been possible to come up with a suitable measure for bank reform, it would have been included. But the gradual process of Chinese bank reform precludes the use of a measure, not even a dummy.

<sup>26</sup> Net loans equal gross loans minus loan loss reserves.

<sup>27</sup> See, among others, Shleifer and Vishny ([1986](#)) and McConnell and Servaes ([1990](#)).

<sup>28</sup> Under the system GMM approach, both CI and OIA are instrumented to avoid possible endogeneity problems.

<sup>29</sup> The consumer price index is the deflator with 2000 as the base year.

<sup>30</sup> In all, five versions of the GMM and two of the FE were tested using different specifications. For example, the log of total assets (LOGTA) was tested in other GMM estimations and found to be insignificant. Likewise for the lagged inflation rate. In the FE model it is not possible to test for time invariant dummies such as type of bank. The reported Hansen

<sup>31</sup> See C and the experience in

<sup>32</sup> This is e to total income was between 1% and 2%. The figure ranged from 1% to 2% in China Finance

<sup>33</sup> The re three rural commercial banks, to help reli k, the PBC) adopted a series of policies including government subsidies, preferential taxation and

financial aids. By April 2005, the PBC had swapped CNY36.9 billion worth of central bank bills for CNY31.9 billion of NPLs. It also wrote off CNY4.99 billion of losses incurred by 648 RCCs in the eight provinces selected for the pilot reform. In addition, the PBC extended financial aid to the RCCs in another 21 provinces selected for the second batch of the pilot reform. Source: [www.cbrc.gov.cn](http://www.cbrc.gov.cn).

<sup>34</sup> Policy loans finance key projects designated by the government to be of national importance. In 1994 three policy banks were created for this purpose, so other banks could operate on a national footing. However, banks that are largely state-owned (from the big four to rural coops) continue to be pressured into making these loans.

<sup>35</sup> For more detail, see PBC ([2004](#)).

<sup>36</sup> The lagged inflation rate was dropped because it was insignificant in all seven models tested, and was highly correlated with the other macro variables.

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