Banking Regulation and Corporate Governance

An Empirical Study of Chinese Banks

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A thesis submitted to the Business school, The University of Adelaide, in fulfillment of the requirements for the degree of Doctor of Philosophy

February 2014

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ABSTRACT

Although there is an increasing research interest in banking capital requirements, the impact of the China Banking Regulatory Commission (CBRC) banking regulation on Chinese commercial banks' behaviors has not been fully explored. Even though CBRC banking regulation has tremendously improved the capital adequacy ratio, on average, for Chinese commercial banks in recent years, the question of whether and how different types of banks in China have reacted to constraints placed by the regulator on their capital has not been empirically tested in the literature for Chinese cases.

This overarching research problem, which forms the foundation of this doctoral research project, gives rise to three important research questions. First, do different types of banks in China react differently to capital requirements in terms of capital adequacy level, i.e. do state-owned banks, joint-equity banks, local banks, and foreign banks behave the same in their capital ratio when adhering to changes in capital requirements? Second, do Chinese banks differ in their ability to adjust risk, i.e. do different types of banks simultaneously adjust their capital and risk due to the influence of binding capital requirements? Third, do corporate governance factors jointly work with banking regulation in explaining Chinese banks' risk behaviors, i.e. does corporate governance have significant impact on the banks' risk level and affect the relationship between change in capital and change in risk? These three issues correspond to the three gaps found in the extant literature on the CBRC regulation, also in the strand of empirical studies focusing on the role of capital standards for regulating banks' behavior. To explore these research questions, this research tries to provide extensive

empirical evidence from three interrelated projects, each with a unique contribution to informing the research topic.

These closely related, investigative components jointly provide consolidated answers to the three research questions proposed previously. In response to the first research question, I show that regulation does affect all banks in the way they adjust their capital levels, although the degree to which this occurs does vary. Specifically, regulation has a stronger positive influence on capital ratios for unlisted banks, joint-stock banks and foreign banks, but a relatively weaker, positive influence on the capital ratios of the 'Big 5' banks, and local banks (i.e. city and rural commercial banks). With respect to the second question, I find that regulation does not have any impact on the risk ratio for banks where the state is the largest shareholder; it only has the expected and negative effect on risk levels for predominately non-state owned banks and unlisted banks (which primarily are the local and rural commercial banks). Therefore, banks with a large degree of state ownership still face a certain degree of credit risk. As for the last research question, my findings indicate that although corporate governance factors do have expected effects in reducing banks' risk, it is the specific feature of the bank itself that plays a major role in explaining their risk behaviors associated with binding capital requirements.

This doctoral research makes a valuable contribution to the field of the Chinese banking industry. From the theoretical perspective, it fills the significant gaps in the existing banking literature, adopts the specific variables to distinguish Chinese banks' unique character, extends knowledge and theoretical foundations, and identifies important issues which require further investigation. From the practical perspective, it follows well-established models and applies the complicated estimation technique to show the effects of Chinese banking policy on different types of banks. My empirical results will contribute to the continuously improving the CBRC regulation by providing useful suggestions regarding whether these binding capital requirements have positive influences on commercial banks' performance in terms of capital adequacy level and risk control.

DECLARATION

I, Yishu Fu, certify that this work contains no material which has been accepted for the award of any other degree or diploma in any university or other tertiary institution and to the best of my knowledge and belief, contains no material previously published or written by another person, except where due reference has been made in the text.

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ACKNOWLEDGEMENTS

First and foremost, I would like to extend my immense gratitude to my principle supervisor, Prof. Ralf-Yves Zurbrugg, for his unreserved support. This thesis would not have been completed on time without his efficient feedback, rich experience and detailed guidance which ensured the quality of my work. His warm encouragement helped me always keep a positive attitude towards life. Above all, I became more confident about my research ability under his supervision. I really enjoyed working with him and would like to offer him my most sincere thanks.

I also would like to thank my co-supervisor, Prof. Chien-Ting Lin, for his useful guidance and advice on my last project, which helped me to finish my thesis on time. In addition, I also would like to express my sincere gratitude to Prof. Shih-Cheng Lee, for his enormous guidance and assistance during the infant stage of my PhD research. I am indeed indebted to him.

Many thanks to the business school for its support for doctoral students and the insightful feedback on my research proposal and research projects. I personally thank Dr. Juan Luo and Dr. Jiun-Lin Chen for their mentoring supports and feel particularly grateful to my good friends Chang, Juan, Shan, Shasha, Yessy… life here would never have been so colorful without them. Lastly, I would like to thank my parents, who are the most important people in my life. They have always been so supportive and patient and have given me enormous love and strength for so many years.