

Research on the Current Situation and Countermeasures of Investment Banking of Chinese Commercial Banks

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Abstract

With the continuous improvement and innovation of the business model of commercial banks, investment banking plays an increasingly important role in the business system of commercial banks in recent years. Compared with the western developed capitalist countries, the investment banking of Chinese commercial banks developed rapidly with strong vitality, though started late. However, with the continuous development of Chinese capital market and the changes in the economic environment at home and abroad in recent years, all kinds of problems still emerged though the investment banking of Chinese commercial banks is in a stage of sound development. The text analyses the problems of investment banking of Chinese commercial banks and gives corresponding suggestions by comparing the development and current situation of investment banking at home and abroad and combining the Chinese social-economic environment in recent years.

Keywords

Commercial Bank, Investment Banking, Social-Economic Environment

1. Introduction

What is investment banking? According to the CEO of Morgan Stanley, Gae-mon, accepted definition of what the investment banking at present is that: Investment bank is an important financial intermediary in capital market and the main function of which is to provide financial services for capital demanders and capital suppliers [1]. Investment banking can be roughly divided into two parts that for the primary market that is the issuance and underwriting of securities and for the secondary market that is the broken dealer operations after the issuance.

Investment banking and commercial banks are inextricably linked in the modern market economy [2]. Firstly, the relationship between the capital market that targeted by investment banks and the currency market that targeted by commercial banks is tight and secondly investment banks and commercial banks are all intermediaries in the financial market, but investment banks are just intermediaries for investors and fundraisers in the capital market, while commercial banks are for depositors and accommodators in the currency market. Besides, we should also note that different parties will have different rights and obligation in investment banking and commercial banking business. The investment banking department of each securities traders is a link between investors and financiers in the investment banking business and earns commissions, so it will generate rights and obligations directly between investors and financiers. On the contrary, commercial banks play an intermediary role in the indirect market which mainly serves between depositors and accommodators, so commercial banks are both the supplier and the demander of funds and finally there is no direct relationship of rights and obligations between depositors and accommodators [3].

The investment banking can be traced back to the 1980s and there were many trusts and investment companies appeared, which have played the role of investment banks in some ways and began to undertake most of the investment banking business though they are not proper investment banks. In the mid-to-late 1980s, China had established a large number of securities companies which started late, but developed rapidly, though there are still some problems such as the relatively smaller capital, the relatively lower specialization degree and inadequate innovation and other problems [4]. The State Council issued the *Decision of the State Council on Reform of the Financial System* in 1993, which clarifies the principle, the divided operation and management that implemented by Chinese trust companies, insurance companies, securities companies and commercial banks to control financial risks within the acceptable range. *The Law of the People's Republic of China on Commercial Banks* establishes the principle of separate banking operation in the form of law, which passed in 1995. This series of reforms are not properly separated operation or mixed operation in developed countries, but only a transitional stage. Now, the investment banking in our country has shown signs of transforming into the mainstream model of international banks that transformed from the traditional business of deposit and loan and settlement as the main to the new business of intermediary services. Although we have made satisfactory progress and achievements, there are still some problems such as lack of experience, unitary service and lack of innovation compared with international investment banking [5].

The investment banking of commercial banks in China can be traced back to 2002 that the Investment Banking Department was first established by the Industrial and Commercial Bank of China, which is the earliest and largest investment banking department of commercial banks with most complete and perfect

service in China, and has formed a significant brand effect [6].

2. Literature Review

Diamond (1983) believes that banks can provide a wider range of financial products to bring huge profits to banks according to its advantages of the diversified business and the strong information. Radić, N., Girardone, C., & Fiordelisi, F. (2010) indicated from the survey that most American commercial banks have a better performance and work more efficiently in bond underwriting than investment banks [7]. Morrison, A. D. (2008) denied the traditional view that the integration of commercial banking and investment banking would lead to bigger systemic risk [8]. Laux, C. and Walz, U. (2009) put forward the view that the investment banking of commercial banks can promote their competitiveness and believed that the commercial banks have more advantages in resources and information in the capital market and the currency market to improve their operational efficiency [9]. Banerji, S. and Basu, P. (2010) put forward that the securities and insurance business of commercial banks can be helpful to reduce the operational and financial risks of commercial banks [10]. Balogun and Jacobs (2002) agreed that investment banks play a key role in the capital market and are conducive to the efficient operation of the capital market. Vennet, R. V. (2002) have analyzed the underwriting cost and gross profit rate between commercial banks and investment banks and demonstrated that the development of part of the underwriting business of commercial banks has a great role in promoting their own development [11]. Degl'Innocenti, M., Fiordelisi, F., Girardone, C. and Radić, N. (2018) put forward the assumption of merging commercial banks and investment banks into a comprehensive and universal bank and believed which would be helpful to promote the development of financial markets. Schlottmann and Mitchell believed that one of the major challenges the current investment banking faced is the integration of financial risks [12].

Schlottmann, F., Mitschele, A. and Seese, D. (2005) believed that the investment business of commercial banks in China is over the hill in recent two years, but in the long term, if we can break the bottleneck and optimize our own income structure, there will be a long way to develop for the investment business of commercial banks in the future [13]. Balluck, K. (2015) put forward that commercial banks should adhere to the marketization's concept and formulate short-term and long-term marketing strategies that meet their own development conditions in developing investment business [4]. Junguo Zheng (2003) put forward that the main obstacles Chinese commercial banks facing at present are that the lower maturity of Chinese capital market, without relevant laws and regulations and customers' recognition need to be improved in commercial banks carrying out investment banking [14]. Keping Chen (2009) believed that the investment banking of Chinese commercial banks should be based on the actual situation of the development of Chinese capital market and further expand the development space and implement the internationalization strategy

gradually to achieve the specialized and characteristic operation [15].

3. Research Methods

1) Literature Research Method

The text puts forward the author's thesis and research direction on the basis of summarizing and refining the relevant arguments from different authors by carefully reading the interrelated previous literature research, especially the empirical articles.

2) Comparative Research

Firstly, the text summarizes the research methods and directions at home and abroad by comparing the thesis views of different scholars at home and abroad. Secondly, the text puts forward constructive suggestions for Chinese commercial banks to carry out investment banking business by comparing the development process and business differences of investment banking between Chinese and American commercial banks.

4. The types of Investment Banking in Chinese Commercial Banks

1) Bond Business

Bond business mainly includes underwriting and distribution and the main purpose is to meet the financial demand of enterprises, especially diversified financial demand and to help enterprises reduce financing costs.

2) Financial Advisory Business

Financial advisory business plays an increasingly important role in the investment banking system of modern commercial banks. An orderly financial advisory business can not only help commercial banks win advisory service fees and gain new profit growth points, but also provide reference data related to the risks management for loan customers to better reduce operational risks.

3) Equity Financing Business

The equity financing business in the present investment banking department of commercial banks in China mainly provides equity financing or the hybrid financing of equity and debt financing for high-risk and high-growth emerging enterprises and large state-owned enterprises or central enterprises.

4) Asset Management Business

The asset management is quite different from the asset management in securities companies, which mainly focus on bank financing that has become the fastest growing business of the banking industry in the past decade and the popularity among the public is also increasing.

5) ABS Business

ABS is Asset Securitization Business. The ABS business of banks mainly includes asset securitization of non-performing assets, credit assets and infrastructure and etc. Asset securitization not only plays a great role in revitalizing illiquid assets, optimizing the allocation of bank assets, achieving revenue and

reducing the operation risk, but also alleviating the regulatory pressure of deposit and loan from supervision departments to better diversify operational risks.

5. Risk Analysis of the Investment Banking in Commercial Banks

1) Macro Policy Risks

According to the previous empirical analysis, the development of the whole market economy has a significant effect on the development of investment banking that the introduction or abolition of a policy will lead to a major change in one or even several businesses [16]. Therefore, the practitioners of investment banking of commercial banks need to be very familiar with the latest national policies and economic situation.

2) The Industry Regulation Risks

The main legal basis for the operation of Chinese investment banking is the *Securities Law*. Therefore, the practitioners investment banking of commercial banks must effectively avoid the possible legal risks.

3) The External Market Risks

A variety of economic factors will have a numerous effect on investment banking, such as interest rate fluctuation risk, stock price fluctuation risk, exchange rate fluctuation risk, commodity trading risk and basic risk and etc. The practitioners of investment banking should closely monitor these macro and micro economic factors and minimize the possible adverse impact on investment banking.

4) Operational Risks

The main sources of business operation risk are the risk of decision-making, financial risk, personnel management risk and technical risk and most of them are caused by human factors, so they should be paid enough attention during daily work.

5) The Risks of Credit Loss

Credit loss risk is a risk caused by credit crisis, which is very common in the daily management of investment banking and mainly including credit default risk, settlement risk and bankruptcy risk.

6) The Risks of Capital Adequacy

As we all know that the capital adequacy plays an important role in the daily operation and development of a company. Jia, L.I., Zhou, R., School, B., *et al.* (2017) think that an adequate capital can not only meet the needs of business expansion and improve competitiveness in the same industry, but also greatly help companies to resist risks [17].

7) Liquidity Risks

The liquidity risk of most commercial banks is mainly due to the lack of liquidity in their financial structure and it has roughly three main reasons that the wrong collocation of financial products' term, all kinds of financial products are less easily accessible and the improper management of arbitrage.

6. Problems in Current Investment Banking of Chinese Commercial Banks

1) The Rigid Structure

Although the investment banking of Chinese commercial banks has made great progress and achievements, the main business is still to take deposits and make loans to earn interest margins. In order to make the investment banking business get more attention and achieve great development in commercial banks, it is necessary to change the business system of Chinese commercial banks essentially, especially in changing the dominant situation that taking deposits and making loans.

2) Inadequate Capability in Business Management

The supporting rules and regulations of investment banking, a new business in Chinese commercial banking systems, are still in the early construction stage, which should be the same with the securities companies' that establish a complete system covering contracting, undertaking and underwriting and promote the business standards of relevant practitioners.

3) The Serious Phenomenon of Part-time Jobs

The headquarters of major commercial banks have special investment banking departments and relevant persons in charge, but it is limited in the branches. According to the previous survey report that many customer managers are part-time investment banking management in branches [18]. In order to achieve the scale development of investment banking in commercial banks, it is necessary for each branch to have a president and a section chief in investment banking to avoid the part-time phenomenon as far as possible.

4) Insufficient Response Management of Investment Banking

The risk of investment banking is special and complex that the disposal procedures are relatively more, besides the necessary legal proceedings, the disposal of collateral should also be carried out and if the result is so serious that may also lead to the reputation risk.

5) Imperfect Internal Mechanism

The current risk control measures of Chinese commercial banks are not perfect and even can not cover the needs of their corresponding products at all. As everyone knows that the development and implementation of investment banking need to pass a strict approval process, otherwise it will cause serious risks out of control. Therefore, it is necessary to establish a sound internal control system and strengthen the power and responsibility system.

6) Imperfect Incentive Mechanism

Chinese investment banking incentive mechanism, whether it is in the investment banking department of securities companies or the investment banking department of commercial banks, are not fully execute in accordance with the international general investment banking incentive mechanism [19]. If the staff reward and punishment mechanism is not perfect, it is difficult to motivate employees and achieve the sound development of performance.

7) The Puzzlement of External Multiple Economic Factors

Since the second half of 2014, the global economic situation has gradually declined and investment banking business has been greatly impacted that the growth of Chinese economic situation is not obvious. Although China has launched a 4 trillion yuan stimulus plan, the negative effects of its sequelae are becoming more and more obvious and the adverse effects of these macroeconomic factors will have a great shock on the investment banking of commercial banks [20].

7. Suggestions for Commercial Banks to Develop Investment Business

1) Changing the business thinking of commercial banks and the existing business structure of “Taking Deposits and Make Loans”. Then with the maturity of Chinese capital market, a number of commercial banks continue to upgrade and transform their industries and the simply taking deposits and making loans can not only be helpful with the new profit growth points for enterprises, but also increase the operational risk of commercial banks. Therefore, it is necessary to change the dominant business situation of “taking deposits and making loans”.

2) Establishing a sound risk transmission and isolation mechanism. The “firewall” system must exist widely in every aspect of investment banking. The most important link in the “firewall” system is the examination and approval of a reasonable system and investment desperation system, and the bank must do a good job of monitoring the rights.

3) Establishing and improving the internal control system. The financial advisory business and equity financing business account for a considerable proportion among the existing investment banking of Chinese commercial banks [21]. It is necessary for the two core investment banking businesses to establish sound internal control measures to reduce operational risks to a controllable range.

4) It is necessary to improve the professionalism and ethics of relevant practitioners and practitioners of investment banks should constantly learn new laws and regulations and the development experience of foreign and domestic counterparts and constantly improve their own professional skills.

5) The laws and regulations on the investment banking of commercial banks should be perfect [22]. The main legal basis of investment banking of Chinese commercial banks at present is *the Securities Law*, but lacks of guidance documents for specific businesses. Therefore, it is necessary to implement legal documents to various departments and even to various types of business to improve the loopholes of the law regulations.

6) It is necessary to strengthen the innovation of business types and product types. In terms of market innovation, we should not only keep the traditional PPP business, but also pay attention to the investment business Pre-IPO and PE. In terms of customer innovation, we should attach importance to government

customers and listed and proposed listing customers. In terms of product innovation, banks can expand actively managing fund business and combined fund management business. In terms of business model innovation, it is necessary to link up with the asset management business in the industry.

Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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