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A Chinese view of governance and the financial crisis: An interview with ICBC's chairman

Jiang Jianqing discusses the need for balance within an effective governance model and the ways the financial-services industry will change in China in the wake of the global economic crisis.

Dominic Barton, Yi Wang, and Mei Ye

Regulators struggling to fix the world's troubled financial institutions may take heart from the experience of China's large state-owned banks. In the late 1990s, Chinese state lenders were all but insolvent, with nonperforming loan ratios at many banks exceeding 50 percent. A decade later, China's state banks have found their footing—and have managed to keep it amid a global financial crisis that has their European and US counterparts reeling. The bad-loan ratio has been reduced, and this year China's state banks expect solid profits and continued rapid growth—despite the global downturn. What's more, top bank executives express confidence in their capacity to heed government instructions to boost lending while effectively controlling credit risk.

Industrial and Commercial Bank of China (ICBC) is generally regarded as the strongest of China's state-owned bank giants. It is also the largest bank by market capitalization and total profits—both in China and the world—with total assets of more than $1.4 trillion. ICBC chairman Jiang Jianqing met recently with McKinsey's Dominic Barton, Yi Wang, and Mei Ye to share his thoughts on corporate governance, risk management, and the origins of the financial crisis.

Jon Krause

The *Quarterly*: *Why has ICBC put so much effort into thinking about corporate governance?*

Jiang Jianqing: We share the vision of the Basel Committee[1] that good governance is essential not only for the stability of the banking industry but also for the economy as a whole. Effective governance is the means of building and maintaining the qualities that are at the foundation of all commerce: confidence and public trust. It's disheartening to see how many financial institutions lost sight of these basic truths. I find it ironic that some of the financial institutions that have struggled or even collapsed in wake of the financial crisis were touted as global role models before the crisis struck.

[1] An advisory panel including representatives from some of the world's leading central banks.

Jiang Jianqing

Vital statistics

Born February 1953, in Shanghai

Married, with 1 child

Education

Graduated with degree in finance and economics in 1984 from Shanghai University of Finance and Economics

Earned MA (1995) in engineering and PhD (1999) in management from Shanghai Jiao Tong University

Career highlights

Industrial and Commercial Bank of China (ICBC)
- Chairman and executive director (2005–present)
- President (2000–05)
- Vice president (1999–2000)
- President, Shanghai branch (1997–99)
- Vice president, Shanghai branch (1993–95)

ICBC (Asia)
- Chairman (2000–present)

Shanghai Municipal Cooperation Bank (now Bank of Shanghai)
- President (1995–97)

Fast facts

Vice president of the China Banking Association and the China Society for Finance and Banking

Senior faculty fellow and PhD supervisor, Shanghai Jiao Tong University

Has written for more than 20 publications

Distinguished Performance Award for Global Leadership by *Committee for Economic Development* (2008)

Named one of China's 25 most effective entrepreneur leaders by *China Entrepreneur Magazine* (2007 and 2008)

Leadership Achievement Award by *The Asian Banker* (2006)

I remember the findings of a 2002 McKinsey survey[2] concluding that institutional investors will pay a premium for stock offered by well-governed companies, especially in developing markets. The survey also found that, in deciding where to put their money in these countries, investors pay more attention to governance issues than to financial metrics. We recognize that corporate governance is an important tool for maximizing shareholder value, and that's why we put so much effort into thinking about it.

The *Quarterly*: *What lessons have you drawn about governance in the wake of the financial crisis?*

Jiang Jianqing: My view is that there is no single model of effective governance. What works in some countries or cultures may not work elsewhere. In the United States and Europe, equity investment is highly fragmented, so management of the company must be delegated to a board or a small number of key executives, and various incentive mechanisms must be used to motivate people at the helm to run the company in a way that creates value.

Many Asian businesses are controlled by a single family. Family-run firms are thought to be highly efficient. But regulating the relationship between large and small shareholders is often a problem. In China, large banks and businesses favor a model in which the state owns a large proportion of company shares. In our case, for example, Central Huijin Investment and China's Ministry of Finance each hold more than 30 percent of ICBC shares. Such arrangements aren't unique to China: in Austria, Israel, Singapore, and many other nations, the proportion of state ownership for large companies can range from 40 percent to 70 percent. The challenge with this model is how to manage complex networks of trust agency relationships. In these types of organizations, reliance on incentive systems alone tends to do more harm than good.

Each model has its strengths and weaknesses. They all bear careful study. It seems to me there are no obvious best practices. But we've learned from the financial crisis that there are plenty of *worst* practices.

Running a bank is like running a marathon: getting a fast start doesn't assure success. Indeed, runners in the lead after the first 1,000 meters may not even make it to the finish line. In a marathon, the key to victory is stamina and a balanced pace. Similarly, balance is the secret to effective governance. More specifically, what I mean by this is you have to balance

[2] See "Global Investor Opinion Survey," July 2002, mckinsey.com.

short- and long-term profits, as well as short- and long-term risks. I'm certainly not suggesting the Chinese approach to corporate governance is perfectly developed. But I do think there are flaws in the Western system of relying so heavily on incentive systems.

The *Quarterly*: *How do you control risk in a big institution like ICBC and how do you build that into the culture of the organization?*

Jiang Jianqing: We've learned our lessons on risk. In June 1999, the nonperforming loan ratio at ICBC reached 47.5 percent. At the time, some Western media claimed Chinese banks were technically bankrupt. You can't imagine the pressure we bankers faced then.

The first step in addressing the problem was to focus on risk management. After I was appointed president[3] in 2000, one of the first things I decided was that we must hold the nonperforming ratio for new loans to less than 2 percent of assets. We created a credit-management system to control existing and new loans. By addressing irregularities and punishing violators, the quality of new loans quickly improved. Since then, ICBC has kept its nonperforming ratio for new loans to 1.7 percent.

Changes in the regulatory environment helped as well. In the wake of the Asian financial crisis, the Chinese government reorganized and developed the nation's financial regulatory system, putting great emphasis on risk management, creating the China Banking Regulatory Commission, enacting a range of new rules and regulations, and introducing stricter external auditing and accounting standards. China's large commercial banks developed sound governance structures and were subjected to close scrutiny from investors as they prepared to list shares publicly. This combination of internal and external factors substantially improved the governance of China's financial institutions and left them in much better shape to manage risk today. Now ICBC's bad loan ratio has been reduced to 2.2 percent.

[3]Jiang became chairman of ICBC in 2005.

In the end, though, the key to risk control is employing good people. That's why we put so much emphasis on ethics and developing a corporate culture that values precision, professionalism, and teamwork. Good governance is impossible without a good corporate culture.

The *Quarterly*: *In response to the global financial crisis, the Chinese government has recently announced a series of measures to spur domestic demand. How do you balance concerns about maintaining credit quality with the bank's social responsibilities and government directives to support growth?*

Jiang Jianqing: The government's recent decision to boost domestic demand offers a great opportunity for the banking industry. However, ICBC is a commercial bank and we have to view these opportunities from the business perspective. I believe we have the ability to seize the opportunity and spur economic growth while also controlling risks. The fact that China's finance industry has not been badly hit by the ongoing crisis should be attributed to great efforts and timely reform initiated by the Chinese government after the Asian financial crisis. The high-risk situation that China's banking institutions experienced before is the last thing we want to see this time.

*'We shouldn't reject the need for innovation in financial services merely because it carries some **element of risk** with it'*

The *Quarterly*: *Has the financial crisis altered your thinking about the merits of introducing more complicated forms of financial products, such as credit default swaps or other derivatives?*

Jiang Jianqing: Derivatives weren't the straw that broke the camel's back. The current crisis is the result of a combination of problems. We shouldn't reject the need for innovation in financial services merely because it carries some element of risk with it. In China, we say: you can't stop eating just because you're afraid of choking on your food.

China's challenges differ from those faced by financial institutions in more developed economies. We haven't suffered severe losses in the current crisis, because we didn't invest in the complicated products that triggered it. But if you think carefully, this could be exactly where challenges emerge in the days to come. As interest rates are increasingly determined by the market and financial disintermediation that develops in China, the traditional loan-led banking model is bound to change. We'll have to have more complicated financial products. Yes, we need to minimize risk, but we can't dispense with innovation. The question is how to strike the proper balance. China's banking industry will suffer setbacks. The best we can hope is to limit the pain of adjustment.

The *Quarterly*: *Could you talk a bit about your board? What do you expect your board to do to help you?*

Jiang Jianqing: It is currently composed of 15 directors—4 executive directors, 7 nonexecutive directors, and 4 independent directors. I see the board as the soul of a company. Sound corporate governance has a lot to do with a board's structure, decision making style, and efficiency. The quality of a board's members determines the board's ability to perform its duties. A good board structure should be independent, professional, ethical, honest, and dedicated.

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Our board has made great efforts to enhance ICBC's development and risk management. Shortly after the company went public, the board developed a three-year plan with specific targets around restructuring, regional development, innovation, differentiated service, cross-border operations, comprehensive risk management, IT, and HR. In the past three years, those targets have all been met or exceeded. These efforts have earned us global recognition. Last year, *The Banker* magazine picked ICBC as its "Bank of the Year" for Asia. We also were honored for excellence in corporate governance by the Chamber of Hong Kong Listed Companies.

The *Quarterly*: *What are your goals for the bank in the years ahead?*

Jiang Jianqing: Recently we designed the strategy for 2009 to 2011. We resolved that we will become the world's most profitable, preeminent, and respected bank.

Given our size, we feel we should be able to earn larger profits than any other bank. We seek rates of ROE,[4] ROA,[5] and income per customer on par with the highest levels in China and overseas. Since the introduction of international auditing, in 2003, we've enjoyed a CAGR[6] of 37.5 percent

[4] Return on equity.
[5] Return on assets.
[6] Compound annual growth rate.

in profits—making us one of the fastest-growing banks in the world. Our goal is to extend this cycle of profitability and rapid growth. We've set high standards of excellence for corporate governance, customer service, and financial innovation. We also aspire to be a global leader in the financial-services industry—with a strong brand name and a solid record for corporate citizenship and social responsibility.

The *Quarterly*: *What are your plans for international expansion?*

Jiang Jianqing: We're very cautious when it comes to investing. Before the crisis, we had many opportunities for acquisition. Fortunately we resisted that temptation. We have a clearly defined strategy. Any potential acquisition target must expand our regional footprint and improve ICBC's core competencies and long-term returns. So our overseas expansion will be a gradual process—another marathon. Q

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