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Dimensions of Regional Processes in the Asia-Pacific Region

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Part 3. Risks & Challenges

Introduction

Asia and Pacific's growing importance to the rest of the world is widely acknowledged today. The dynamics of Asian economic development have tremendously impacted global trade relationships and regional cooperation. Thus, it is with great pleasure that we deliver another volume of Research Papers on Asia-Pacific economic issues.

This year we present 19 papers by various authors who examine the Asia-Pacific region from different perspectives. We decided to group them into 3 Chapters:

- Cooperation and trade
- Economy and policy
- Risks & challenges

Papers grouped in the First Chapter describe newly emerging regional trade architecture. You will find there a few analyses of general nature and regional scope (J. Dudziński, A. H. Jankowiak, E. Majchrowska) and some studies on specific trade agreements (A. Klimek writes about Shanghai Free Trade Zone, A. McCaleb and G. Heiduk try to find out what motivates China's cities to establish partner agreements with cities in Asia, B. Michalski analysing U.S.-Republic of Korea Free Trade Agreement, while M. Maciejewski and W. Zysk look for opportunities for Polish exports in the trade agreement between EU and Vietnam).

The Second Chapter is the most diverse one. It is devoted mostly to economic policy issues (including financial sector). S. Bobowski, L. Zyblikiewicz and K. Żukrowska look at the main threads in Asian regionalism. P. Pasierbiak and K. Łopacińska analyse the movements of Chinese capital. M. Dziembała and S. Mazurek deal with the subject of innovation supporting growth and development.

Articles in the Third Chapter are focused on extraordinary events influencing economies and development of the Asia-Pacific region. J. Pera prepared an assessment of risk of APEC countries, based on the country risk classification method and selected indexes of internal stability. A. Kukułka and B. Totleben analyse the impact of natural disasters on gross capital formation in Southeastern Asia. Finally, T. Serwach and M. Grabowski and S. Wyciślak deal with synchronization of business cycles and contagion of crises.

We sincerely hope that all the articles will be of great value to those who want to understand the role of Asia-Pacific economies in the global economy. Through various interests of authors, our volume provides a valuable insight into the problems of this region.

All the papers where submitted for the 8th international scientific conference "Dimensions of Regional Processes in the Asia- Pacific Region" which took place in

November 2015 at Wroclaw University of Economics, under the patronage of Polish Ministry of Foreign Affairs, Ministry of Science and Higher Education and the Ministry of Economy.

We appreciate your time and consideration, and we look forward to the submission of your own good work. We also appreciate the time and effort of our peer reviewers. Thank you!

Bogusława Drelich-Skulska, *Anna H. Jankowiak*, *Szymon Mazurek*

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STRATEGIC ALLIANCE BETWEEN CHINA DEVELOPMENT BANK AND BARCLAYS AS A BASIS FOR THE EXPANSION OF CHINESE CAPITAL IN THE BANKING SECTOR

PARTNERSTWO STRATEGICZNE CHINA DEVELOPMENT BANK I BARCLAYS PODSTAWĄ EKSPANSJI KAPITAŁU CHIŃSKIEGO W SEKTORZE BANKOWYM

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Summary: The paper presents the development of the international expansion of Chinese enterprises from the banking sector, based on the example of the strategic partnership formed after the acquisition of the shares in the British Bank Barclays by China Development Bank. The analysis covers both, the circumstances that led banks to establishing this agreement and its implications in the face of the outbreak of the global economic crisis. Attention is especially focused on the China Development Bank as a socially responsible institution and its contribution to building economic stability and fuelling sustainable development.

Keywords: strategic partnership, banking sector.

Streszczenie: W artykule przedstawiono rozwój międzynarodowej ekspansji przedsiębiorstw chińskich z sektora bankowego na przykładzie partnerstwa strategicznego powstałego po przejęciu udziałów w angielskim banku Barclays przez China Development Bank. Analizie poddane zostały zarówno przesłanki, które skłoniły banki do nawiązania tego porozumienia, jak i jego skutki w obliczu wybuchu światowego kryzysu gospodarczego. Uwaga została szczególnie skupiona na China Development Bank jako społecznie odpowiedzialnej instytucji i jej wkładzie w budowanie stabilności gospodarczej oraz napędzanie zrównoważonego rozwoju.

Słowa kluczowe: partnerstwo strategiczne, sektor bankowy.

1. Introduction

Strategic alliances form fundaments for future development and expansion of enterprises in various market sectors and trades, since they offer a broad range of benefits for the involved parties. Increased market competition and expansion policies are the most important factors behind alliances of this type. For this reason, a strategic partnership may be interpreted in the context of building company competitive advantage and the adopted strategy for development. Strategic alliances open up new expansion prospects and offer better potential for development through the acquisition of new knowledge and the synergistic effect of joint efforts and competences. It must be noted, however, that alliances of this type are also a source of new challenges, particularly when the partnering parties represent different cultural backgrounds.

This paper presents the nature of and the rationales behind the Chinese companies in the banking sector and the role of strategic alliance, as exemplified by the case study of China Development Bank and their decision to invest in British Barclays.

2. The international expansion of Chinese enterprises in the banking sector

Internationalisation of banking operations is an important trend in the development of modern banking industry, formed as a result of the continued globalisation of the sector. The involvement of banks, particularly the large ones, in operating and issuing activities outside their country of origin is reflected in elaborate geographical structure of their operation, location of branches and filial units, stakeholder structure, and multi-currency banking operations [Markiewicz 2013, pp. 370-382]. The internationalisation trends in the banking sector and banks' involvement in international-scale operations have been observed for centuries, but these processes have definitely escalated since the early 1970's, with the increased globalisation of the financial markets.

For over a decade now, the aspirations of Chinese enterprises to increase their influence on the global and international scale have been meticulously realised through the 'go global' strategy. Those internationalisation trends are also evident in the banking industry. Not so long ago, Chinese banks were the popular targets of direct investment for foreign financial institutions. In the recent years, the tide has turned. Following the structural reforms designed to sanitise the Chinese financial sector, the condition of Chinese banks has improved significantly. The large commercial banks and smaller regional banks, previously burdened with heavy outstanding debt, started to expand, not only through increased FDI and Initial Public Offerings on foreign stock exchange markets, but also through physical expansion – a wide network of filial and agency organisations, coupled with takeovers of foreign financial institutions. With impressive capital at their disposal, and taking opportunity in the recent slump of global financial markets, the Chinese banks have departed on a mission to become the most important players in the field.

China's present involvement closely resembles the post-war strategy of Japan: it involves unrestrained expansion to the most distant parts of the globe. The present Chinese economic commotion has had the effect of increasing the number of organisations aspiring to global riches. For many Chinese enterprises, the 'go global' strategy has proven quite effective, to say the least. These internationalisation trends have also been observed in the banking industry. With the opening of new stock exchanges and the official consent from the government to issue Initial Public Offerings on foreign markets, the Chinese banks received a huge capital inflow and the associated expert knowledge. On the other hand, the continued high dynamics of economic development added to market capitalisation of Chinese banks. In addition, China's Banking Regulatory Commission has offered their sustained support for the integration of Chinese banks with foreign organisations, as part of the national policy of development. The resulting capital inflow, coupled with pressures from stakeholders and reforms on the institutional level, has had the effect of greatly boosting Chinese investment in foreign financial and non-financial institutions. It has also stimulated the banks to actively pursue a 'physical' expansion strategy based on global networks of filial branches and agencies [Cieślik 2009].

China Development Bank (CDB) is a prime example of a banking institution providing support for Chinese enterprises, in line with the national 'go global' strategy. The bank, controlled by the central government, is fully committed to its mission: long-term financing of large infrastructural projects (motorways, railways, gas pipes, power stations), strategic sectors of national economy (mining, petrochemical, telecommunications, hi-tech) and regional development (western provinces and the industrial areas in the north-east). The bank has also been involved in many international projects deemed strategically important for China, with such partners as: China National Petroleum Corporation, Sinopec, ChemChina, China International Trust and Investment Corporation. Other projects included: the Kazakhstan-China pipeline, copper mining in Chile (China Minmetals), China International Trust and Investment Corporation's purchase of oil fields in Kazakhstan (bought from Canadian National Energy Company), as well as a number of company takeovers, such as the French company Adisseo (by ChemChina) and Peru Copper Inc. (by China Aluminium Corporation). In addition, China Development Bank has initiated a number of independent expansion projects, as exemplified by the fairly recent acquisition of Barclay's shares (The UK) [Gradziuk, Szczudlik-Tatar 2012, pp. 8-13].

3. The rationale behind the development of the strategic alliance between China Development Bank and Barclays

In 2003, China was ranked the second largest oil consumer and the third largest importer of oil, globally. At present, 40% of oil used in Chinese economy comes from import, and this share is expected to double by 2025, as a result of China's strong emphasis on international investments in the energy and raw materials sectors. Chinese banks provide support for their investors, both through competitive pricing strategies and through facilitated access to raw materials. These efforts have been exemplified by the growing expansion of Chinese companies on such markets as Middle East, Central America, Australia and Canada, and their aggressive tactics with respect to strategic reserves of energy materials in Africa [Sia Partners 2014; Jerin 2014].

Faced with the global financial crisis, the China Development Bank and numerous other banking institutions in China decided to depart from the previous strategy of investing in financial sectors and focus on taking control of the most important raw material suppliers, particularly oil and gas companies deemed of utmost strategic importance for Chinese economy. This strategic shift, imposed by the Chinese government, has had the result of intensifying the volume of Energy Backed Loans issued by China Development Bank [Downs 2011]. The CDB, along with other Chinese banks, such as China International Trade and Investment Corporation, the Industrial and Commercial Bank of China, Sinosure, China Export and Credit Insurance Corporation, and China Export Import Bank, entered into cooperation with the Chinese oil companies to help them negotiate profitable energy material contracts with African countries. In addition, the Chinese financial sector giants were actively involved in a number of strategic partnerships – in the form of mergers and acquisitions – with companies deemed to be of key importance for their market position and for the effective realisation of the adopted financial strategy [Jerin 2014].

The case study of the CDB-Barclays alliance is a prime example of the Chinese strategy of mergers and acquisitions on the European market, and the largest one so far, in terms of net transaction value. In 2007, the China Development Bank purchased 3.1% of shares from Barclays – one of the largest banking institutions in the UK – for €2.2bn ($3.1bn). The transaction was designed to help Barclays raise its offer for the largest Dutch bank – ABN Amro. Should the deal go through, the Chinese bank declared to increase their investment to an outstanding sum of €9.8bn, to the effect of becoming the biggest external investment by a Chinese company in the documented history [Wearden 2007].

The dominant position of Barclays in the regions rich in raw materials, such as South Africa, Zambia, Zimbabwe and Nigeria, gave rise to the China Development Bank's involvement in the transactions, since it offered China better access to raw material deposits on the global market. Barclays, in turn, as an institution specialising in commodities trade, hoped that the alliance would improve their position on the market. In October 2007, i.e. three months after the signing of the alliance agreement, both parties announced their joint decision to form a Commodities Strategic Alliance. In effect, the China Development Bank became the largest stakeholder in Barclays. The British bank, in turn, managed to increase their involvement in commodity projects and largely improved their potential for proper evaluation – and realisation – of this type of transactions. In addition, the British bank pledged to assist China Development Bank in their aspirations to raise their effectiveness in trade execution and risk management infrastructure, as well as to provide the support in all matters concerning PR management and deal negotiation in these countries and regions which, due to status reasons, pose barriers and limitations to regulate the involvement of Chinese state-owned enterprises.

Barclays' strong position as the third largest commodities bank in the world seemed to support the CDB's judgement of the British bank as the best partner for the long-term development of their commodities' business capabilities. Thus, the commodities market and, most of all, the shared vision of the future development of global mining industry and raw material market, proved to be the most important factors behind the parties' decision to enter into strategic alliance, and helping the Chinese bank transform into a fully commercial financial institution.

The decision to invest in Barclays, however, was not entirely based on the commodities and raw material aspects. The merger, to a large extent, was also a manifestation of the CDB's ambition to transform into a global enterprise of international character. At first, the prospect seemed feasible. CDB was to become the largest stakeholder in the British bank, which was, at that time, attempting to take over the largest Dutch bank – ABN Amro. Should the deal come to a successful conclusion, and with further investment of CDB amounting to £5.1B, this would mark the biggest ever merger in the banking sector, to the effect of elevating the CDB's status on the global market [BB PLC 2015].

4. The effects of strategic alliance between China Development Bank and Barclays

With the onset of the global financial crisis, the CDB's tie-up with Barclays, despite its considerable potential, proved to be ill-timed, to say the least. The value of many investment projects concluded at that time, including the net value of the new strategic alliance, plummeted rapidly. In December 2008, shares in Barclays dropped by an alarming 79 percent, from £7.20 to £1.54. Although, by 2010, the Chinese bank had managed to recover part of their losses, the value of their shares was still considerably lower than their original closing bid. Despite these problems, ever since the signing of the alliance agreement in 2007, both the China Development Bank and Barclays perceived each other as 'valuable partners'. In practice, this was manifested, among other things, by the Chinese decision to continue the strategic alliance in the face of the global financial crisis, and the consecutive decision to prolong the terms of the strategic agreement.

In 2014, China Development Bank and Barclays announced their plans of joint cooperation in the provision of banking and investment services on African markets. At the same time, this decision had the effect of reinforcing the position of London as the main trade node for the Chinese yuan. The original strategic alliance agreement of 2007 was replaced by a Memorandum of Understanding, signed in 2014 in Beijing, to reflect the changes that have taken place since then in both partnering entities. In line with the new provisions, the British partner undertook to provide assistance to their Chinese counterpart in all matters concerning the development of corporate and investment banking services. Moreover, the China Development Bank was offered access to all retail and business banking platforms held by Barclays in 14 African countries. The parties declared their will to provide mutual assistance and ensure complementarity of their pro-development activities on the global market and to reflect this approach in their training projects. In addition, the updated agreement regulates certain issues concerning trade of currencies, shares and bonds. The document "provides a more relevant framework that will further strengthen the strategic relationship between both organisations" [BAG 2015].

China Development Bank perceives the renewed alliance as a chance to realise their supreme goal – to depart from the government-focused bank formula and reach the status of a commercial lender – which can only be achieved through continued international expansion, particularly through investment support for Chinese companies seeking their opportunities in the resource-rich market of Africa [Jerin 2014].

The annual financial reports disclosed by China Development Bank confirm their ongoing development trend and their potential for sustainable growth, with improved knowledge of risk management and risk control procedures in all areas of their business operations. This is attested by the impressive 26% asset increase registered in 2014 alone, bringing it up to the level of ¥10.3tn, with profit at ¥97.7bn (Fig.1). Positive results of the agreement are also attested by return on assets and equity (at 1.06% and 15.63%, respectively) and capital adequacy ratio of 11.88%.

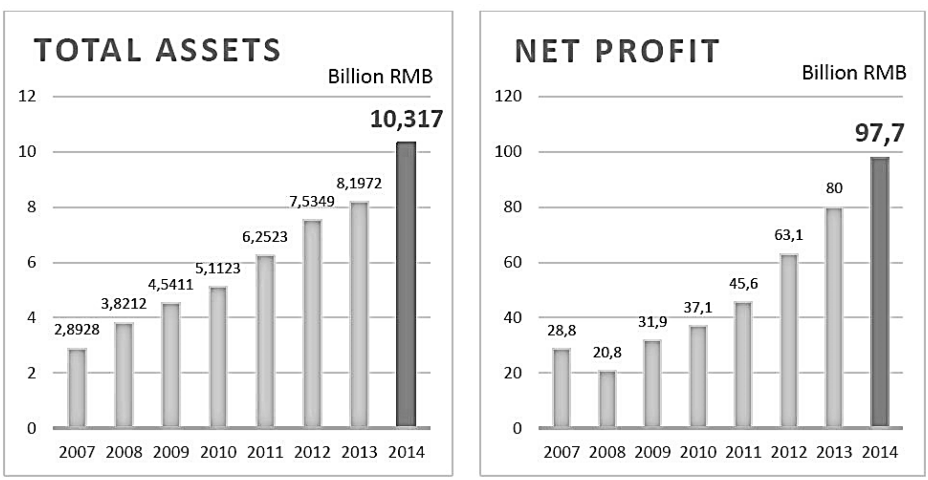

Fig. 1. China Development Bank's assets and net profit analysis between 2007 and 2014.

Source: Own study, based on CDB [2008], [2009], [2010], [2011], [2012], [2013], [2014].

China Development Bank' steady growth trend continues year to year, with impressive profitability increase. With an increase of 21.83%, the earnings were at ¥128.88bn. It must be noted that interest receivables were the main source of earnings for the bank, rising by 4.19%. The bank retained their involvement in loan syndication, registering a significant increase in both, treasury bills and asset management. Total value of loans granted by China Development Bank in 2014 amounted to ¥1.84tn, a 20% increase compared to 2013 values, with the total value of bonds issued registered at ¥1.17tn, including ¥6.7bn from retail and ¥18bn from exchange. It may also be interesting to note that ¥2.5bn invested in Hong Kong and ¥2bn in London have greatly contributed to the increased internationalisation of the Chinese currency. The significant increase in assets denominated in foreign currencies, on the other hand, was a result of the bank's active development on international markets, as attested by the widening scale of global operations.

It must also be noted that China Development Bank is an active player on the loan market. In 2014, the total value of pro-development loans was at ¥1.11tn, with further ¥119.5bn invested in railroad infrastructure and ¥81.4bn on waterways infrastructure. Another noteworthy segment of CDB operations is the promotion and restructuring of the Chinese economy and national welfare. In 2014, the bank set up a fund for the integrated development of the industry, with ¥218.2bn assigned to the development of emerging sectors and ¥42.5bn for cultural-type projects. Other forms of involvement included: ¥32.6bn for agriculture, ¥61.9bn for SME development, ¥14.7bn for student credits, ¥147.7bn for anti-poverty projects, ¥2.1bn for disaster management, and ¥500m for retirement pensions. The bank is also actively involved in financing the restoration of impoverished regions, with ¥408.6bn assigned to this task in 2014 alone.

It may be interesting to note that, following the introduction of the 'go global' strategy, the bank has offered their continuous support for Chinese companies seeking to expand to foreign markets and improve their global competitive advantage through various forms of strategic alliances. In 2010 alone, China Development Bank provided financial support for 438 international projects, with a total value of $117.6bn. By 2014, the list of beneficiaries of CDB's support included such Chinese industry giants as: Sinopec, PetroChina, Huawei, China Minmetals and ZTE [IDFC 2015].

China Development Bank has successfully continued their international investments in such sectors as green energy, infrastructure, mining, telecommuni-cations, and SME development. Since 2011, they have retained their position as the leader of loans denominated in foreign currencies, estimated at $169.8bn.

Also in 2011, China Development Bank declared their investment involvement in at least 90 countries of the world, with partnership relations kept with ca. 140 countries. Fig. 2 shows strong position of Taiwan and Australia as the leading partners for CDB in terms of the number of transactions: 28 and 26 agreements, respectively. However, with respect to the total value of investments, the dominance

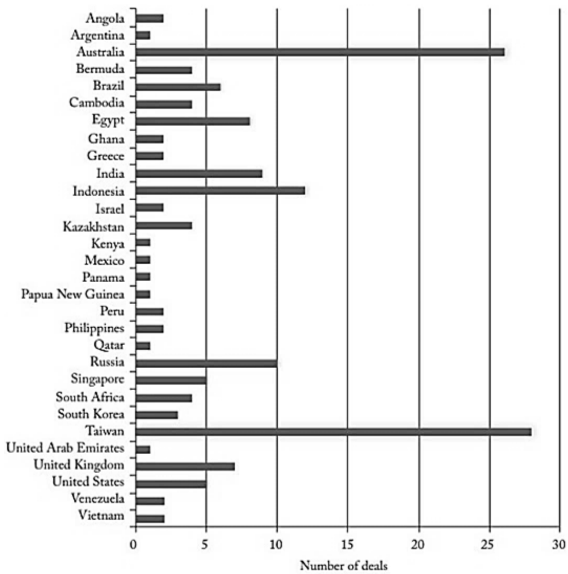

Fig. 2. China Development Bank Overseas deals per country between 2002 and 2012 in terms of number

Source: Friends of the Earth [2012, p. 9].

of United Kingdom and Russia are uncontested. For the UK, the bulk of the total investment volume is related to the agreement between China Development Bank and Kazakhmys, a British mining company actively involved in Kazakhstan. Similarly, the bulk of Russian investment is directly related to the CDB shares held in Vnesheconombank, the Russian Development Bank. Other major foreign recipients of CDB's investments include India, Indonesia and Mexico – clear leaders in terms of the capital value of telecom investments. Interestingly enough, the position of Mexico as the 6th largest partner is owed to a single agreement held between the CDB and America Mobile, with value of $1bn. However, it must be remembered that CDB's foreign investment is predominantly focused on the acquisition of raw materials. For instance, Australia is a key partner for CDB for coal and iron ore transactions [Friends of the Earth 2012].

CDB is also a key player in the process of forming banking alliances within the framework of such structures as the Shanghai Cooperation Organization (SCO), China-ASEAN Dialogue and BRICS. A good example here is the CDB's support (2014) for the Shanghai Cooperation Organization Interbank Association and the China-ASEAN Interbank Association. The above initiative has led to the formation of the Silk Road Fund, a special fund for strategic regional integration of Asian and European countries, and the strategy's promotion (One Belt, One Road – a strategy for the promotion of international cooperation).

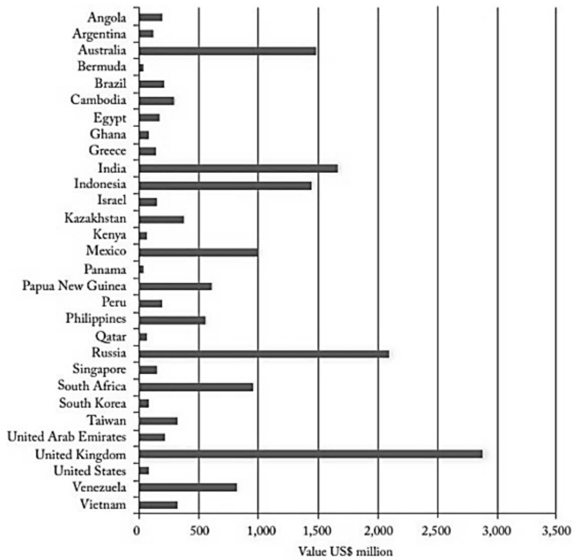

Fig. 3. China Development Bank Overseas deals per country between 2002 and 2012 in terms of value

Source: Friends of the Earth [2012, p. 9].

To attest to the successes of China Development Bank, the company received the Financial News *Bank of the Year: International Cooperation* award in 2010, and an award of excellence from the Institute of Finance and Banking of the Chinese Academy of Social Sciences for their continued trade intermediation support in international agreements. Lastly, it may be useful to emphasise the CDB's active involvement in Corporate Social Responsibility practices, which is an inherent element of the bank's strategy of operations, deeply ingrained in the bank's corporate culture.

In this context, it comes as no surprise that the bank's commitment in pro-development and preservation of, not only national, but also global economic stability, has gained recognition from the global community. CDB was the first national Chinese bank to join the ranks of the United Nations' Global Compact [IDFC 2015], the largest global initiative comprising 10 000 corporate entities. The UN project is designed to promote global entrepreneurship and business cooperation through sustained and socially responsible business policies, particularly in such areas as the recognition and protection of human rights, improving work standards, environment protection and reducing corruption.

5. Conclusions

The case study of China Development Bank's acquisition of shares in British Barclays and the resulting strategic alliance, as presented in the paper, is a prime argument in support of the thesis that Chinese banking institutions – in their investment strategies – are not restricted to purely financial objectives. Their decisions are often motivated and influenced by additional, non-financial factors. Some of the more obvious motives for international expansion include the strife to maintain and increase their market position, prestige and global brand recognition. There are, however, certain other – decidedly less conventional – reasons behind such decisions. These include [Cieślik 2009, pp. 18-22]:

- the access to new customers and evaluation of their needs, which are oftentimes in striking contrast to the Chinese way of thinking;
- a chance to benefit from many years of experience gathered by foreign financial institutions already involved on the highly competitive global markets;
- learning the tools of the trade, such as the new innovative financial instruments and systemic solutions contrasting with those used by the Chinese companies;
- making use of the already prominent position of the partnering organisation – this is of particular benefit to regional Chinese banks,
- the identification of cultural and organisational differences between local and international institutions;
- learning the skills needed to operate under different economic systems;
- access to best practices for control and management of banking risk.

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