



## Cooperation Satisfaction and Performance: Empirical Evidence from Chinese Banks and Their Foreign Strategic Investors

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### Abstract

*In this paper, we investigate whether the mutual satisfaction of Chinese banks and foreign strategic investors (FSI) in terms of their cooperation with each other affects the performance of Chinese banks. Since 2004, China's banking authority has conducted an annual survey on Chinese banks and their FSI, assessing levels of mutual satisfaction in terms of their cooperation. We use these survey results to examine the effects of satisfaction levels on the profitability of Chinese banks. Our results reveal that satisfaction affects profitability; that is, satisfied foreign investors and Chinese banks yield better performance. Satisfaction determinants for each party are also examined. Although the profitability of Chinese banks does not show a significant effect on the satisfaction of either party, bank loan to deposit ratios, regions of FSI home countries, and the type of Chinese banks are important factors that might affect satisfaction.*

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**Key words:** bank performance, Chinese banks, foreign strategic investor, satisfaction

**JEL codes:** G21, M21

### I. Introduction

The effects of foreign participation in the Chinese banking system have recently attracted considerable attention from governments, practitioners and academia. Although foreign banks enter the market through their own branches or subsidiaries in most countries, foreign

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investment in Chinese banks has taken the form of minority shareholding with limited management involvement (Podpiera, 2006). In China, a minority shareholder with holdings of more than a 5 but less than a 20-percent interest is referred to as a foreign strategic investor (FSI).<sup>1</sup> Whether FSI sufficiently influence the management of Chinese banks to implement necessary reforms and make the banks consistently profitable is questionable. Whether the operational performance measures of local banks, such as return on assets (ROA), improve after FSI join these banks has been examined (see e.g. Wu *et al.*, 2007; Zheng and Feng, 2007; Shen *et al.*, 2009). Some studies investigate whether there are improvements in profit and cost efficiency after the opening of Chinese banks to FSI (Berger *et al.*, 2007). Results typically reveal a beneficial effect of minority foreign ownership on performance.

To understand the relationship between Chinese banks and their FSI, the China Banking Regulatory Commission (CBRC) has conducted an annual survey of Chinese banks and their FSI since 2004, focusing on mutual satisfaction in terms of cooperation. The surveys are issued to 21 Chinese banks with FSI as the second or third largest shareholders, and to 24 foreign investors who joined Chinese banks as FSI. The survey contains six categories, including general cooperation, corporate governance and operation mechanisms, management framework and business development, risk management and internal control, corporate culture and human resources, and infrastructure. The Chinese banks and their respective investors were asked to rate their satisfaction in terms of cooperation with each other for the six aspects during the past year.

Although there are several studies that consider the influence of FSI, no studies examine how mutual satisfaction between local banks and FSI can affect bank performance. Earlier studies regarding the link between satisfaction and firm performance usually focus on customer and employee satisfaction. For example, with respect to customer satisfaction in marketing, Mittal and Kamakura (2001) and Faulhaber (1995) demonstrate that higher customer satisfaction levels yield higher customer retention rates, increase repurchase behaviors and, ultimately, drive firm profitability higher. With respect to employee satisfaction, Vavra (1995) points out that satisfied employees increase the productivity of a firm. That is, if employees are generally satisfied with their work environment, they will apply themselves in their work. Therefore, although satisfaction is a subjective concept, it is also closely related to the actual performance of a firm.

Despite abundant studies regarding the effects of customer and employee satisfaction, minimal discussion on the satisfaction of company board members exists. In particular, to the best of our knowledge, no existing studies discuss the mutual satisfaction levels between

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<sup>1</sup> Although each FSI only holds 5–20 percent of a Chinese bank's stocks, most FSI have become the second or third largest shareholders of the banks they invested in.

the controlling and the second largest shareholders. Previous research has discussed conflicts of interests among large shareholders. For example, Harford *et al.* (2007) use the acquisition data of US listed companies to find that conflicts of interests among board members are considerable and affect managerial decisions relating to acquisitions. Although their study is not directly related to satisfaction, it reflects that coordination among large shareholders affects corporate governance. Coordination of interests among board members and large shareholders is related to corporate decisions and performance; therefore, we can reasonably infer that higher satisfaction in terms of cooperation among these parties might improve performance.

The aim of the present paper is to investigate whether the mutual satisfaction of Chinese banks and FSI in terms of their cooperation with each other affects the performance of Chinese banks. We expect a connection between mutual satisfaction and bank performance for two reasons. First, higher satisfaction in terms of cooperation might imply fewer conflicts of interests between the two parties and, therefore, enhance bank performance. Furthermore, when the mutual satisfaction indices increase, the two parties are more satisfied with what each other has contributed and, therefore, are more willing to devote themselves to the banks and share their confidential information. This definitely raises the probability of improvements in bank performance. Using the abovementioned satisfaction evaluations from 2004 to 2006, we examine the link between mutual satisfaction and local bank performance.

The investigation of the link between satisfaction and performance, however, is interlined with an econometric issue, which is that satisfaction itself might also be affected by bank performance. To solve this endogeneity problem, studies on the link between social and financial performance propose corrective estimation methods. Garcia-Castro *et al.* (2010) suggest using the fixed effect method to remove the endogeneity bias. However, in their models, the social event of interest is a dummy variable, in contrast to the current study where satisfaction is a continuous variable. Thus, their suggestion cannot be directly applied to the present study. In addition, because satisfaction is not a random event, the simultaneous equation system is used here to remove the endogeneity problem. Although a considerable number of studies on the determinants of satisfaction exist, few studies concerning the banking industry have been conducted.<sup>2</sup> Even fewer studies focus on a transition country such as China.

The present study has strong policy implications. First, it helps to clarify whether the opening-up of banks to FSI has had a positive influence on the local banking industry. Our study reveals that a key factor for the success of FSI in Chinese banks is satisfaction in

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<sup>2</sup> Satisfaction studies in different fields are abundant, such as those considering job satisfaction, customer satisfaction and cooperation satisfaction between allied partners.

terms of cooperation from both sides. Therefore, strategies to improve cooperation should be the focus of policy relating to the opening-up of Chinese banks, rather than the lifting of the upper limit of FSI shareholding proportions. Second, the present study discusses the importance of the regions where FSI come from and the types of local banks in determining satisfaction in terms of cooperation. For this reason, the results might serve as a reference in reviewing policy effects and mapping out a blueprint for further opening-up of banks. Third, our study provides a roadmap for future potential foreign investors interested in investing in Chinese banks. Although most big banks already have foreign partners, many city commercial banks do not. This study is a preliminary guide for these foreign investors.

The paper is organized as follows. Section II describes FSI in the Chinese banking market and defines the seven survey satisfaction indices (formed from the six categories mentioned above plus an overall index). Section III, IV and V introduce satisfaction measures, econometric model and data. Section VI presents empirical results concerning the effects of both parties' satisfaction on Chinese bank performance as well as the determinants of satisfaction. Section VII concludes.

## II. Foreign Strategic Investors in China

In 1996, the Asian Development Bank acquired a 1.9-percent ownership stake in China Everbright Bank and became the first foreign investor via equity investment. This is the first time that the China authority permitted a foreign investor to hold a stake in local banks. A formal policy was announced in 2001. At the end of 2003, the CBRC promulgated the administrative rules governing equity investment. According to the rules, the equity investment of an individual foreign institution in a Chinese bank shall not exceed 20 percent and the aggregate equity investment shall not exceed 25 percent. This deregulation of foreign equity investment, along with the fast economic growth of the Chinese market, has encouraged foreign institutions to participate in the Chinese banking industry.

To ensure that foreign institutions are strategic rather than financial partners, in which the former correlates to long-term relationships and the latter emphasizes short-term relationships, the China banking authority proposes the following prerequisites for FSI: the shareholding of an FSI is required to exceed 5 percent; the locking period for selling shares is 3 years; FSI have to transfer management skills; and the FSI itself should have a strong financial background, management experience and willingness to cooperate. Each FSI is permitted to invest in two Chinese banks at most. FSI fulfilling these requirements can obtain one or two seats on the board. Under these arrangements, FSI might still have a substantial influence on Chinese bank performance despite their minority shareholding status.

Table 1 presents the status of equity investments in Chinese banks by foreign financial

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**Table 1. Chinese Banks' Introduction of Foreign Strategic Investors**

Chinese banks	Foreign institutional investors	Equity investment amount	Equity investment proportion of a single overseas institution (%)	Combined equity investment proportion of all overseas institutions (%)	Time of investment
<b>State-owned banks</b>					
Bank of Communication	HSBC Group	RMB1.747bn	19.9	19.9	August 2004
Bank of China	Royal Bank of Scotland Group, Merrill Lynch	US\$3.1bn	10	19.92	August 2005
	Temasek Holdings	US\$1.52bn	5.88		
	Li Ka Shing Foundation	US\$0.75bn	2.4		
	UBS, AG	US\$0.5bn	1.64		
China Construction Bank	Bank of America	US\$2.5 bn	8.52	13.62	September 2005
	Temasek Holdings	US\$1.466bn	5.1		
Industrial & Commercial Bank of China	Goldman Sachs, Allianz, American Express	US\$3.78bn	10	10	January 2006
<b>National Joint-stock Commercial Bank</b>					
China Everbright Bank*	Asian Development Bank	US\$19m	1.90	1.90	January 1996
Shanghai Pudong Development Bank	Citibank	US\$67m	4.62	5	August 2002
		(increased to 5% in November, 2003)			
China Mingsheng Bank	International Finance Corporation	RMB0.23bn	1.22	5.77	November 2003
	Temasek Holdings	US\$0.11bn	4.55		October 2004
Shenzhen Development Bank	New Bridge Investment GE Group	RMB1.235bn	17.89	24.89	June 2004
		US\$0.1bn	7		September 2005
China Industrial Bank	Government of Singapore Investment Corporation	RMB1.726bn	5	24.98	March 2004
	International Finance Corporation		4		
	Hanseng Bank		15.98		
Bohai Bank	Standard Chartered	US\$0.15bn	19.9	19.9	September 2005
CITIC Bank	CITIC International Financial Holdings Limited	HK\$5.544bn	19.9	19.9	April 2006
Guangdong Development Bank	Citibank	ND	19.9	19.9	September 2006
Hua Xia Bank	Deutsche Bank AG	ND	13.98	20.86	March 2006
	Pangaea Capital Management		6.88		October 2005
<b>City commercial bank</b>					
Bank of Shanghai	HSBC Group	US\$62m	8	16	December 2001
	Shanghai Commercial Bank, HK	RMB196m	3		
	International Finance Corporation	US\$25m	2		
Nanjing City Bank	International Finance Corporation BNP Paribas	US\$9m	5	24.2	November 2001
		RMB0.7bn	19.2		October 2005
Xi'an City Commercial Bank	International Finance Corporation NOVA Scotia	ND	2.5 2.5	5	October 2004
Bank of Beijing	Internationale Nederlanden Group N.V. (ING) International Finance Corporation	RMB 1.78bn	19.9	24.9	March 2005
		US\$ 54m	5		
Hangzhou City Commercial Bank	The Commonwealth Bank of Australia	RMB0.625bn	19.92	19.92	April 2005
Nanchong City Commercial Bank	DEG SIDT	EUR3m	10	13.3	July 2005
		EUR1m	3.3		
Ningbo Commercial Bank	Oversea-Chinese Banking Corporation Limited	RMB0.57bn	12	12	January 2006
Jinan City Commercial Bank	The Commonwealth Bank of Australia	RMB0.62bn	19.9	19.9	September 2005
Bank of Tianjin	ANZ Banking Group	US\$0.11bn	19.9	19.9	2006
Chongqing City Commercial Bank	Dah Sing Bank	US\$89m	17	17	December 2006
Qingdao City Commercial Bank	Intesa Sanpaolo SpA Rothschild	US\$0.172bn	19.90	24.90	July 2007
		US\$42m	5.00		

Source: Shen *et al.* (2009).

Note: \*China Everbright Bank was the first bank to receive the equity investment of a foreign investor in 1996. Because this was far before the time that the rules governing equity investment were enacted, China Everbright Bank became an exception of the minimum requirement of the 5-percent equity investment proportion. ND, no data.

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institutions within the past decade. The following four interesting results can be gathered from the table. First, except for the Agricultural bank, which has no FSI, all state-owned banks have between one and four FSI. Second, four-fifths of state-owned banks and three-quarters of national joint-stock commercial banks have introduced FSI, but less than one-tenth of city banks have introduced FSI.<sup>3</sup> This implies that national and large banks are the priority of FSI, whereas regional and small banks are the second choice. Third, the highest shareholding proportion by any single foreign investor is 19.9 percent under the 20–25-percent rule. Finally, the minimum equity holding percentage is 5 percent, making the combined equity investment range from 5 to 19.9 percent.<sup>4</sup>

Most foreign investors come from the USA or Canada or from European countries, including the UK, France, Holland and Germany. Others are from Asian countries or regions, including Chinese Hong Kong, Singapore and Korea. A common attribute among these countries or regions is that they are all developed. Management expertise of foreign investors is used to improve the performance of Chinese banks. This is the main purpose of the Chinese Government policy to introduce FSI.

### III. Satisfaction Measures

This is the first paper to investigate satisfaction in terms of cooperation as well as the performance of the banking industry in the rapidly growing economic system of China. In what follows, we describe the unique satisfaction data used to carry out the present study.

As mentioned in the Introduction, data are taken from the surveys of the CBRC. The surveys contain 40 questions for Chinese banks and 30 for FSI. These questions, as mentioned in the Introduction, are divided into six categories. Each category has 6–8 questions, which are averaged to yield a final score for the category studied. The six categories include general cooperation (*General*), corporate governance and operation mechanisms (*Govern*), management framework and business development (*Manage*), risk management and internal control (*Risk*), corporate culture and human resources (*Culture*) and infrastructure (*Infra*). Values of the six indices range from 1 to 5, with higher values denoting greater satisfaction. The six indices are further averaged to achieve the overall index (*Overall*).

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<sup>3</sup> At the end of 2007, there were 5 state-owned banks, 12 national joint-stock banks and 124 city banks in China.

<sup>4</sup> Some foreign investors would unite other investors as one FSI in order to conform to the minimum requirement of equity holding percentage, including Li Ka Shing Foundation, UBS, AG, International Finance Corporation, Temasek Holdings, Investment Corporation, Shanghai Commercial Bank, HK, International Finance Corporation, International Finance Corporation, NOVA Scotia and SIDT.

Table 2. Variable Definition and Data Source

Variable	Definition
<i>Satisfaction_C and Satisfaction_F</i>	
<i>Overall_C</i>	Satisfaction scores of Chinese banks toward FSI in all evaluations
<i>General_C</i>	Same as above in general cooperation
<i>Govern_C</i>	Same as above in corporate governance and operation mechanism
<i>Manage_C</i>	Same as above in management framework and business development
<i>Risk_C</i>	Same as above in risk management and internal control
<i>Culture_C</i>	Same as above in corporate culture and human resource
<i>Infra_C</i>	Same as above in infrastructure
<i>Overall_F</i>	Satisfaction scores of FSI toward Chinese banks in all evaluations
<i>General_F</i>	Same as above in general cooperation
<i>Govern_F</i>	Same as above in corporate governance and operation mechanism
<i>Manage_F</i>	Same as above in management framework and business development
<i>Risk_F</i>	Same as above in risk management and internal control
<i>Culture_F</i>	Same as above in corporate culture and human resource
<i>Infra_F</i>	Same as above in infrastructure
<i>Bank_C and Bank_F</i>	
<i>Asset_C</i>	Chinese banks' assets, logarithmic transformed
<i>Equity_C</i>	Chinese banks' equity-asset ratio, $100 \times \text{equity/assets}$
<i>LoanDep_C</i>	Chinese banks' loan-deposit ratio, $100 \times \text{loan/deposit}$
<i>NII_C</i>	Chinese banks' net interest income ratio, $100 \times \text{net interest income}/(\text{net interest income} + \text{non-interest income})$
<i>Asset_F</i>	Foreign investors' assets, logarithmic transformed
<i>Equity_F</i>	Foreign investors' equity-asset ratio, $100 \times \text{equity/assets}$
<i>LoanDep_F</i>	Foreign investors' loan-deposit ratio, $100 \times \text{loan/deposit}$
<i>NII_F</i>	Foreign investors' net interest income ratio, $100 \times \text{net interest income}/(\text{net interest income} + \text{non-interest income})$
<i>Share_F, D<sub>region</sub> and D<sub>type</sub></i>	
<i>Share_F</i>	Percentage of foreign shares in Chinese banks' stocks
<i>D<sub>America</sub></i>	Equal to 1 if FSI are from America, 0 otherwise.
<i>D<sub>Asia</sub></i>	Equal to 1 if FSI are from Asia, 0 otherwise.
<i>D<sub>Europe</sub></i>	Equal to 1 if FSI are from Europe, 0 otherwise.
<i>D<sub>Australia</sub></i>	Equal to 1 if FSI are from Australia, 0 otherwise.
<i>D<sub>state</sub></i>	Equal to 1 if the Chinese bank is a state-owned bank, 0 otherwise.
<i>D<sub>joint</sub></i>	Equal to 1 if the Chinese bank is a joint-stock commercial bank, 0 otherwise.
<i>D<sub>city</sub></i>	Equal to 1 if the Chinese bank is a city commercial bank, 0 otherwise.

**Source:** All satisfaction variables and foreign-owned shares (*Share\_F*) are taken from the China Banking Regulatory Commission's survey, whereas financial ratios (*Bank\_C* and *Bank\_F*) are mainly taken from *Bankscope*.

**Note:** Variable extension "C" represents Chinese banks and "F" represents foreign investors. FSI, foreign strategic investors.

In each category, both Chinese banks and FSI are asked about reciprocal satisfaction. The response of each category generates two indices: one index is based on the Chinese view (satisfaction of Chinese banks toward FSI) and the other is based on the foreign view (satisfaction of FSI toward Chinese banks). Therefore, our notation contains two parts. Using *General* satisfaction as an example, the two views are denoted as  $General\_C_{ijt}$  and  $General\_F_{ijt}$ , which indicate the  $i$ th Chinese bank's *General* satisfaction toward the  $j$ th FSI at year  $t$  and the  $i$ th FSI's *General* satisfaction toward the  $j$ th Chinese bank, respectively. Using *Governance* satisfaction as another example, the two views are denoted as  $Govern\_C_{ijt}$  and  $Govern\_F_{ijt}$ . The notation for other categories of satisfaction indices are similarly denoted and are reported in Table 2.

#### IV. Econometric Model

The satisfaction model contains the following equations:

$$ROA\_C_{it} = a_0 + a_1 Satisfy\_C_{ijt} + a_2 Satisfy\_F_{jit} + a_3 Share\_F_{jit} + a_4 Bank\_C_{it} + a_5 D_{region_j} + a_6 D_{type_i} + e_{ijt} \quad (1)$$

$$Satisfy\_C_{ijt} = b_0 + b_1 ROA\_C_{it} + b_2 Share\_F_{jit} + b_3 Bank\_F_{jt} + b_4 Bank\_C_{it} + b_5 D_{region_j} + b_6 D_{type_i} + e_{ijt} \quad (2)$$

$$Satisfy\_F_{jit} = g_0 + g_1 ROA\_C_{it} + g_2 Share\_F_{jit} + g_3 Bank\_F_{jt} + g_4 Bank\_C_{it} + g_5 D_{region_j} + g_6 D_{type_i} + e_{ijt}, \quad (3)$$

where  $it$  and  $jt$  denote the  $i$ th Chinese bank and the  $j$ th foreign investor at time  $t$ . Suffixes  $C$  and  $F$  denote Chinese banks and foreign investors, respectively. There are 21 Chinese banks and 24 FSI, and  $t = 2004-2006$ .  $ROA\_C$  is the ROA of Chinese banks.  $Satisfy\_C$  and  $Satisfy\_F$  are the vectors of satisfaction of Chinese banks and foreign investors, respectively. Each vector contains seven indices, described in the previous section.  $Share\_F$  is the percentage share owned by the foreign investor, and  $Bank\_C$  and  $Bank\_F$  are the vectors of the financial ratios of Chinese banks and FSI, respectively.  $D_{region}$  is the vector of a regional dummy of FSI and  $D_{type}$  denotes the vector of the type of Chinese bank.

Our simultaneous model is estimated using the two-stage-least squares method. First, Equations 2 and 3 are estimated using the OLS method to obtain the predicted values of dependent variables,  $Satisfy\_C$  and  $Satisfy\_F$ . The resulting predicted values are then



used as instrumental variables in Equation 1.

Equation 1 investigates whether the performance of Chinese banks is affected by the satisfaction of Chinese banks and FSI. Note that bank characteristics of FSI do not affect Chinese bank performance, suggesting the exclusion of *Bank\_F* in Equation 1. Equations 2 and 3 are the determinant equations that investigate factors affecting the satisfaction of Chinese banks and that of FSI, respectively. Some variables are omitted in the estimation to avoid multicollinearity.<sup>5</sup>

Our first goal is to investigate whether satisfaction levels between Chinese banks and their FSI affect the performance of Chinese banks. The positive coefficients of  $a_1$  and  $a_2$  suggest that the satisfaction is valuable. The second goal is to investigate whether performance affects satisfaction, which requires  $b_1$  and  $g_1$  to be positive.

Discussion on the control variables, including *Share\_F*, *Bank*,  $D_{region}$  and  $D_{type}$ , is excluded because of space restrictions.<sup>6</sup>

## V. Sources of Data and Basic Statistics

### 1. Sources of Data

Our satisfaction data for 2004–2006 are taken from the survey of the CBRC. The financial ratios of Chinese banks and foreign banks are taken from *Bankscope*, a data bank published by Bureau van Dijk. If the available financial ratios were questionable, such as in the case of a missing ROA or a ratio exceeding 3 percent, relevant websites were searched. The accuracy of the financial data was also verified using the Almanac of China's Finance and Banking. The regional dummies are defined according to the regions where the headquarters of the foreign investors are located, sourcing from the website of each bank. The types of Chinese banks are classified according to the definitions given by the People's Bank of China. Note that the financial ratios of three non-bank foreign financial institutions, namely, Temasek Holdings, Government of Singapore Investment Corporation and New Bridge Investment, are unavailable in *Bankscope* and their respective websites. Hence, the three foreign investors are not used in our sample.

### 2. Descriptive Statistics of Variables

Table 3 presents the descriptive statistics relating to satisfaction of Chinese banks and FSI toward each other. Panel A reveals the Chinese view. Based on the *Overall* evaluation, Chinese banks give the highest scores to FSI from Australia and Europe. High scores are

<sup>5</sup>*AssetC* is omitted from Equation 1 and *Asset\_C* and *NII\_C* are omitted from Equations 2 and 3.

<sup>6</sup>The discussion is available upon request.

**Table 3. Descriptive Statistics of Satisfaction by Regions of FSI**

Panel A: Chinese banks' satisfaction toward FSI								
FSI regions		<i>Overall_C</i>	<i>General_C</i>	<i>Govern_C</i>	<i>Manage_C</i>	<i>Risk_C</i>	<i>Culture_C</i>	<i>Infra_C</i>
Asia	Mean	3.927	3.877	3.941	3.760	4.141	4.017	3.879
	Std error	0.469	0.641	0.716	0.447	0.564	0.688	0.498
	Nobs	40	36	40	31	26	29	14
America	Mean	3.772	3.794	3.953	3.490	3.729	3.615	3.553
	Std error	0.465	0.550	0.479	0.713	0.500	0.653	0.469
	Nobs	37	37	33	35	33	33	16
Europe	Mean	4.021	4.135	4.247	3.737	4.013	3.981	3.500
	Std error	0.365	0.352	0.563	0.422	0.570	0.378	0.519
	Nobs	18	18	16	18	16	18	14
Australia	Mean	4.076	4.020	4.464	3.926	3.981	3.829	3.600
	Std error	0.403	0.391	0.488	0.548	0.520	0.439	0.548
	Nobs	7	7	7	7	6	7	5
Panel B: FSI's satisfaction toward Chinese banks								
FSI regions		<i>Overall_F</i>	<i>General_F</i>	<i>Govern_F</i>	<i>Manage_F</i>	<i>Risk_F</i>	<i>Culture_F</i>	<i>Infra_F</i>
Asia	Mean	3.795	3.941	3.853	3.718	3.634	3.943	3.475
	Std error	0.639	0.591	0.774	0.708	0.881	0.884	0.835
	Nobs	34	32	28	32	26	32	20
America	Mean	4.010	4.131	3.742	4.000	3.976	4.283	3.567
	Std error	0.808	0.868	0.840	0.646	0.727	0.624	0.776
	Nobs	37	36	33	29	30	33	15
Europe	Mean	3.474	3.648	3.045	3.439	3.311	3.708	3.067
	Std error	0.636	0.613	0.350	0.534	0.743	0.771	0.942
	Nobs	16	16	11	16	16	16	15
Australia	Mean	3.667	3.752	4.100	3.556	3.386	3.750	3.500
	Std error	0.638	0.639	0.742	0.900	0.735	0.866	0.866
	Nobs	7	7	5	6	5	4	3

**Note:** FSI, foreign strategic investor; Nobs, number of observations; Std error, standard error.

likewise given to FSI from Asia in *Risk*, *Culture* and *Infra*, but not in *Govern* and *Manage*. Therefore, Chinese banks welcome FSI from Asia when the focus is on cultural understanding and risk techniques. FSI from Australia, however, show effects opposite to those from Asia because Chinese banks are satisfied with FSI from Australia in terms of *General*, *Govern* and *Manage*, but are less satisfied in relation to *Risk* and *Culture*. In summary, Chinese banks are most satisfied with FSI from Australia and Europe, and least with those from America.

Panel B of Table 3 presents the views of FSI; that is, records the satisfaction of foreign

investors toward Chinese banks. Three interesting, but seemingly conflicting, results can be summarized as follows. First, compared with the Chinese view, FSI are slightly more conservative in their evaluation of their Chinese partners. The average score of the Chinese view is approximately 4, but 3.8 from the point of view of FSI. Interestingly, American FSI are quite satisfied with Chinese banks, based on the *Overall* evaluation, which is in sharp contrast to the dissatisfaction of Chinese banks with American FSI. Third, European FSI give the lowest scores to Chinese banks among the four FSI regions, although Chinese banks rate Europe with the second best scores in Panel A.

The three conflicting results relating to mutual satisfaction are challenges in terms of analysis. The first issue is the overwhelmingly higher scores given by Chinese banks than their FSI counterparts. In Chinese culture, “saving face” for others is important, and as both evaluators and evaluatees they tend to give and expect high scores, respectively. High scores are not only beneficial for evaluatees but also helpful for evaluators because evaluatees receiving high scores tend to return the favor to evaluators, which follows a tacit rule of Chinese society. In contrast, developed world culture encourages people to call a spade a spade, treating each evaluation independently. Therefore, Chinese banks give higher scores than foreign banks.

Australian and European banks are welcomed more readily by Chinese banks compared with US banks. This behavior might be because, although these countries all belong to developed world capitalistic societies, their definitions of capitalism differ slightly. Australian and European countries have long-favored the concept of “social capitalism.” In a landmark study on European economies, Kees van Kersbergen (1995) identifies social capitalism as the core component of the European welfare state and situates social capitalism as a middle ground between socialist collectivism and neoliberal individualism. Therefore, the market and social welfare are equally important in deciding the allocation of resources. In 2009, then Australian Prime Minister Kevin Rudd (2009) also echoed the concept of social capitalism.<sup>7</sup> In contrast, the USA relies solely on the market to decide the allocation of resources, and knowledge exchange is based fully on contracts. Because of these cultural differences, chief executive officers in Chinese banks might feel closer to Australian and European investors than to US investors in many respects. Consequently, Chinese banks rate Australian and European investors higher than US investors.

A possible reason for the third conflict is that although European investors are more willing to share their know-how with their Chinese partners, they also expect similar efforts to be made by the Chinese partners. European investors probably did not receive the expected returns, prompting them to grant Chinese banks rather low evaluation scores. Our

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<sup>7</sup> A detailed definition of social capitalism is available at [http://en.wikipedia.org/wiki/Social\\_capitalism](http://en.wikipedia.org/wiki/Social_capitalism).

regression analysis shows similar results.

Mutual satisfaction for American investors is the opposite to that for European investors. The partnership of Guangdong Development Bank and Citibank is a good example. According to a 2008 report,<sup>8</sup> the president appointed by Citibank, Michael Zink, optimistically proclaimed that the reforms and restructuring of management mechanism had enhanced performance and had been helping Guangdong Development Bank to grow steadily. However, many local senior officers complained that the restructuring of the management framework implemented by Citibank not only failed to solve the original problems but also slowed down the further development of Guangdong Development Bank.

Panel A of Table 4 presents the basic statistics for satisfaction ratings given by the various types of Chinese banks. The results show that state-owned banks give FSI the highest evaluation scores, followed by joint-stock commercial banks and city commercial banks. One probable reason for this is that Chinese state-owned banks are also listed in Hong Kong and are used to being evaluated by financial analysts, exposing them to global competition. This global experience means that they tend to be receptive to management skills recommended by FSI, including concepts such as the corporate governance and reward systems. In contrast, city commercial banks conduct their business mainly in local markets and, therefore, lack opportunities to connect with the international capital market and are less familiar with a competitive manner of conducting business.

Panel B of Table 4 reports the satisfaction of FSI toward different types of Chinese banks. FSI are most satisfied with state-owned banks, followed by joint-stock commercial banks, and are least satisfied with city commercial banks. These results are consistent with the panel A data.

## VI. Empirical Results

Table 5 presents the estimated results of Equation 1 using the ROA of Chinese banks as the dependent variable. Four of the seven coefficients of satisfaction of FSI, namely, *Overall*, *General*, *Govern* and *Manage*, are significantly positive, suggesting that foreign satisfaction enhances the performance of Chinese banks. Chinese satisfaction, however, shows relatively ambiguous results. Three of seven coefficients, namely, *Govern*, *Culture* and *Infra*, are significantly positive, whereas *Risk* is significantly negative. Therefore, the view of FSI is more important than the Chinese view in improving the profitability of Chinese banks. This

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<sup>8</sup> Source: A report on the China Economy Net (in Chinese), 29 March 2008. The report is available at [http://finance.ce.cn/macro/main/sys/gz/jr/200803/29/t20080329\\_12899371.shtml](http://finance.ce.cn/macro/main/sys/gz/jr/200803/29/t20080329_12899371.shtml).

**Table 4. Descriptive Statistics of Satisfaction by Chinese Bank Types**

<b>Panel A: Chinese banks' satisfaction toward FSI</b>								
Chinese bank types		<i>Overall_C</i>	<i>General_C</i>	<i>Govern_C</i>	<i>Manage_C</i>	<i>Risk_C</i>	<i>Culture_C</i>	<i>Infra_C</i>
	Mean	4.226	4.236	4.542	3.867	4.157	4.334	4.067
State-owned banks	Std Error	0.316	0.477	0.398	0.463	0.462	0.338	0.258
	Nobs	30	30	24	29	27	28	15
	Mean	3.941	3.907	4.035	3.934	4.063	3.923	3.493
Joint-stock commercial banks	Std Error	0.348	0.498	0.365	0.430	0.643	0.655	0.416
	Nobs	31	27	31	21	22	18	14
	Mean	3.624	3.658	3.736	3.382	3.663	3.471	3.413
City commercial banks	Std Error	0.442	0.524	0.683	0.599	0.459	0.512	0.521
	Nobs	41	41	41	41	32	41	20
<b>Panel B: FSI' satisfaction toward Chinese banks</b>								
Chinese bank types		<i>Overall_F</i>	<i>General_F</i>	<i>Govern_F</i>	<i>Manage_F</i>	<i>Risk_F</i>	<i>Culture_F</i>	<i>Infra_F</i>
	Mean	4.359	4.382	4.462	4.330	4.237	4.538	4.194
State-owned banks	Std Error	0.383	0.462	0.594	0.470	0.405	0.454	0.349
	Nobs	22	19	13	21	21	22	18
	Mean	3.731	3.990	3.641	3.636	3.477	3.639	3.063
Joint-stock commercial banks	Std Error	0.660	0.589	0.690	0.717	0.901	0.932	0.655
	Nobs	28	28	24	24	22	24	16
	Mean	3.626	3.759	3.541	3.525	3.534	4.009	3.059
City commercial banks	Std Error	0.773	0.847	0.776	0.607	0.793	0.696	0.659
	Nobs	41	41	37	36	32	36	17

**Note:** FSI, foreign strategic investor; Nobs, number of observations; Std error, standard error.

result might reflect that the cooperative aspects that the two sides are concerned about differ. Chinese banks seem to pay more attention to *Risk*, *Culture* and *Infra*, whereas *FSI* place more importance on *General*, *Govern* and *Manage*. When they are more satisfied with mutual cooperation in the aspects that they value, the banks the FSI invested in perform better. The only exception is the negative coefficient of Chinese bank satisfaction on *Risk\_C*. When banks pay too much attention to risk management, their profitability performance might be limited or impaired because of the stricter internal risk management rules.

Table 6 presents the determinants of seven satisfaction indices of Chinese banks. Results change when different satisfaction indices are used as dependent variables. First, *Share\_F* seems to be an important factor because the variable has a positive influence on the three Chinese satisfaction indices, *Overall*, *Govern* and *Culture*, suggesting that a

**Table 5. Satisfactions and Chinese Banks Performance (Return on Assets)**

Constant	-0.096 (-0.307)	0.265 (0.857)	-0.744* (-1.943)	0.318 (1.528)	1.307*** (4.159)	-0.331 (-0.779)	-1.188 (-0.585)
Overall_C	0.061 (1.427)						
General_C		-0.004 (-0.083)					
Govern_C			0.135*** (3.771)				
Manage_C				-0.003 (-0.056)			
Risk_C					-0.074*** (-3.351)		
Culture_C						0.099** (2.222)	
Infra_C							0.408*** (3.779)
Overall_F	0.118*** (7.168)						
General_F		0.131*** (6.327)					
Govern_F			0.099*** (3.471)				
Manage_F				0.248*** (6.237)			
Risk_F					0.007 (0.223)		
Culture_F						-0.049 (-1.650)	
Infra_F							0.464 (1.031)
Share_F	-0.001 (-0.646)	-0.000 (-0.156)	-0.000 (-0.007)	0.001 (0.664)	-0.004 (-1.779)	-0.003 (-1.116)	0.006 (1.095)
Equity_C	0.038*** (4.020)	0.036*** (3.821)	0.029*** (3.931)	0.031*** (4.468)	0.028*** (4.088)	0.036*** (3.609)	0.017*** (3.119)
LoanDep_C	-0.004** (-2.926)	-0.004** (-2.811)	0.002 (0.733)	-0.007*** (-4.632)	-0.004*** (-4.537)	0.015*** (3.634)	0.005 (0.394)
NI_C	0.002 (0.740)	-0.001 (-0.210)	0.004 (1.510)	-0.003 (-1.455)	-0.003 (-0.958)	-0.001 (-0.272)	-0.014* (-1.836)
D <sub>America</sub>	0.064 (1.514)	0.067 (1.506)	0.037 (0.600)	-0.059 (-1.491)	0.111** (2.359)	0.113** (2.227)	-0.239 (-0.513)
D <sub>Asia</sub>	0.086** (2.441)	0.108** (2.679)	0.109** (1.998)	0.068** (2.023)	0.139*** (3.650)	0.069 (1.605)	0.004 (0.055)
D <sub>Australia</sub>	-0.026 (-0.437)	0.021 (0.333)	-0.633*** (-3.583)	-0.025 (-0.455)	-0.148** (-2.899)	-1.113*** (-5.097)	0.000 (0.000)
D <sub>Latam</sub>	-0.079* (-1.696)	-0.038 (-0.947)	-0.088* (-1.701)	-0.147** (-2.553)	-0.040 (-0.861)	-0.063 (-1.269)	-0.855** (-2.268)
D <sub>Joint</sub>	-0.155*** (-4.405)	-0.149*** (-4.566)	-0.276*** (-6.066)	-0.133*** (-4.118)	-0.194*** (-5.968)	-0.485*** (-6.818)	-0.220 (-0.472)
R <sup>2</sup>	0.144	0.139	0.218	0.219	0.261	0.242	0.310
Number of observations	80	78	65	64	61	65	33

**Note:** The estimation method is the two-stage least squares method. \*\*\*, \*\* and \* denote significance at the 1, 5 and 10 percent level, respectively. Heteroscedasticity robust *t*-statistics are reported in parentheses.

Table 6. Determinants of Chinese Banks' Satisfaction

	<i>Overall_C</i>	<i>General_C</i>	<i>Govern_C</i>	<i>Manage_C</i>	<i>Risk_C</i>	<i>Culture_C</i>	<i>Infra_C</i>
Constant	3.700*** (9.138)	6.916*** (3.884)	5.314*** (3.917)	4.929*** (4.648)	3.568*** (2.721)	3.388*** (2.626)	2.018 (1.673)
<i>Share_F</i>	0.008*** (3.892)	-0.003 (-0.284)	0.018** (2.218)	-0.004 (-0.687)	0.006 (0.747)	0.016** (2.539)	-0.004 (-0.565)
<i>ROA_C</i>	-0.104 (-0.378)	-1.560 (-1.072)	-0.874 (-0.759)	-0.750 (-0.846)	1.160 (1.177)	0.666 (0.759)	0.685 (0.605)
<i>Equity_C</i>	-0.015*** (-2.697)	-0.042 (-1.472)	-0.048** (-2.090)	-0.020 (-1.123)	-0.014 (-0.710)	0.009 (0.489)	0.014 (0.596)
<i>LoanDep_C</i>	0.008*** (3.582)	-0.010 (-1.025)	0.009 (1.074)	0.010 (1.630)	0.014* (1.872)	0.001 (0.168)	0.008 (0.995)
<i>Asset_F</i>	-0.040 (-1.570)	-0.095 (-1.356)	-0.166*** (-2.835)	-0.107** (-2.151)	-0.074 (-1.387)	-0.040 (-0.674)	0.034 (0.765)
<i>Equity_F</i>	0.017 (1.586)	0.038 (1.016)	-0.036 (-1.194)	0.022 (0.944)	-0.284*** (-4.424)	-0.113*** (-3.926)	-0.213*** (-6.112)
<i>LoanDep_F</i>	0.003* (1.864)	0.005 (1.233)	0.008*** (2.745)	0.007*** (2.947)	0.016*** (4.487)	-0.000 (-0.070)	0.015*** (6.366)
<i>NI_F</i>	-0.007*** (-3.217)	-0.013 (-1.516)	0.004 (0.814)	-0.014*** (-3.349)	-0.022*** (-3.643)	0.010 (1.654)	-0.018*** (-6.128)
<i>D<sub>America</sub></i>	-0.486*** (-9.285)	-0.716*** (-2.986)	-0.385** (-2.269)	-0.263** (-2.003)	0.222 (0.824)	0.271* (1.714)	0.857*** (6.498)
<i>D<sub>Asia</sub></i>	-0.036 (-0.723)	-0.270 (-1.133)	-0.615*** (-4.506)	0.208** (1.973)	1.445*** (7.181)	0.445*** (2.813)	1.362*** (10.000)
<i>D<sub>Australia</sub></i>	0.178** (2.331)	0.082 (0.312)	-0.246* (-1.694)	-0.058 (-0.429)	1.325*** (4.915)	0.181 (1.091)	1.376*** (5.941)
<i>D<sub>ante</sub></i>	0.984*** (28.937)	0.913*** (6.335)	1.653*** (16.939)	0.729*** (11.238)	1.057*** (12.780)	0.797*** (7.474)	0.866*** (7.860)
<i>D<sub>oint</sub></i>	0.567*** (15.860)	0.682*** (4.430)	0.767*** (6.574)	0.258*** (3.160)	1.274*** (9.825)	0.362*** (3.217)	0.278** (1.934)
$\bar{R}^2$	0.587	0.252	0.756	0.406	0.628	0.265	0.730
Number of observations	45	46	43	46	41	45	32

**Note:** The estimation method is the two-stage least squares method. \*\*\*, \*\* and \* denote significance at the 1, 5 and 10 percent level, respectively. Heteroscedasticity robust *t*-statistics are reported in parentheses.

greater proportion of shares owned by foreign investors improves the image of the FSI from the viewpoint of Chinese bankers. Second, the ROA of Chinese banks has no effect on Chinese satisfaction with foreigners. This suggests that, from the point of view of Chinese managers, bank performance is not attributed to foreigners; hence, profitability performance

does not enhance Chinese satisfaction. Third, greater assets, equities and net interest income of foreign banks decrease satisfaction. In other words, large foreign banks are not necessarily welcomed by Chinese bankers. Finally, large loan–deposit ratios of either Chinese or foreign banks provide a positive image, adding to Chinese satisfaction. This suggests that because the conventional business of lending and depositing is still the main focus of Chinese banks, they might experience better cooperation with foreign banks similarly engaged in high loans–deposits.

With respect to the regional effect, our estimated results are interpreted relative to European banks, which are estimated by a constant when other dummies are zero. Therefore, only three dummies,  $D_{America}$ ,  $D_{Asia}$  and  $D_{Australia}$ , are considered. Coefficients of  $D_{America}$  are mostly negative, whereas the coefficients are positive for  $D_{Asia}$  and  $D_{Australia}$ , relative to European banks, implying that Chinese banks are least satisfied with American banks compared to foreign banks from the other three regions. Finally,  $D_{state}$  and  $D_{joint}$  have overwhelmingly positive effects on all the satisfaction indices of Chinese banks. In other words, state-owned banks and joint-stock commercial banks give higher satisfaction ratings to their FSI than city commercial banks do.

Table 7 presents the determinants of the satisfaction of foreign banks toward the Chinese banks they invested in. First, *Share\_F* has no significant effects on any satisfaction index, suggesting that higher shareholdings owned by FSI do not guarantee greater satisfaction. Second, the ROA of Chinese banks again show no effect, implying that the profitability of Chinese banks does not provide a better image for foreigners. Third, foreign banks with greater assets and more equity show decreased FSI satisfaction, suggesting that larger foreign banks are less satisfied with Chinese banks. This is probably because larger banks are more likely to operate businesses based on the stipulations of contracts but Chinese banks often have tacit rules to follow. *LoanDep* ratio, whether in Chinese or foreign banks, is again a positive factor in image improvement. Banks with a higher *LoanDep* ratio, whether Chinese or foreign, tend to have greater satisfaction toward their partners. The same reason mentioned above accounts for this.

With regard to the regional effect, European banks are again the benchmark. We find that the coefficients of  $D_{America}$ ,  $D_{Asia}$  and  $D_{Australia}$  are roughly positive, positive and negative, respectively. With respect to the bank type effect, the coefficients of  $D_{state}$  tend to be positive. These results, combined with those from Table 6, are consistent with the unequal or even conflicting satisfaction ratings between Chinese banks and their FSI shown above.

The unequal satisfaction ratings in our findings are probably a result of the high expectations of FSI. Almost all foreign bankers are from capitalist countries accustomed to the concept of shareholderism, where the chief executive officer is the core decision-maker of the company, and the goals are mainly to maximize profits and minimize costs. FSI that



Table 7. Determinants of FSI Satisfaction

	<i>Overall_F</i>	<i>General_F</i>	<i>Govern_F</i>	<i>Manage_F</i>	<i>Risk_F</i>	<i>Culture_F</i>	<i>Infra_F</i>
Constant	6.264*** (4.057)	6.661*** (3.973)	3.613*** (2.816)	4.259*** (2.797)	7.032*** (3.115)	3.906* (1.783)	5.543 (3.779)
<i>Share_F</i>	0.014 (1.215)	0.012 (1.029)	0.008 (0.766)	0.010 (0.850)	0.011 (0.860)	0.008 (0.423)	0.006 (1.632)
<i>ROA_C</i>	2.011 (1.302)	1.669 (1.046)	2.133 (1.628)	1.638 (1.100)	0.473 (0.287)	3.449 (1.564)	1.225** (2.350)
<i>Equity_C</i>	0.007 (0.217)	-0.001 (-0.026)	0.004 (0.137)	-0.003 (-0.109)	-0.022 (-0.646)	0.047 (1.075)	-0.008 (-0.704)
<i>LoanDep_C</i>	0.024** (2.214)	0.029** (2.680)	0.004 (0.383)	0.010 (0.952)	0.008 (0.694)	0.024 (0.924)	-0.028** (-2.072)
<i>Asset_F</i>	-0.403*** (-5.177)	-0.435*** (-5.106)	-0.110 (-1.125)	-0.222** (-2.556)	-0.300** (-2.770)	-0.319** (-2.298)	-0.111 (-1.176)
<i>Equity_F</i>	-0.065 (-1.402)	-0.081* (-1.773)	-0.104*** (-2.705)	0.033 (0.655)	-0.219*** (-2.690)	-0.067 (-0.936)	-0.169*** (-2.808)
<i>LoanDep_F</i>	0.012*** (3.704)	0.015*** (3.792)	-0.006 (-1.111)	0.013*** (2.860)	0.007 (1.569)	0.012** (2.079)	0.004 (1.499)
<i>NI_F</i>	-0.013** (-2.328)	-0.009 (-1.358)	0.005 (0.622)	-0.019** (-2.547)	0.001 (0.088)	-0.007 (-0.679)	-0.004 (-0.492)
<i>D<sub>America</sub></i>	0.669** (2.642)	0.729*** (2.834)	1.969*** (9.477)	0.498* (1.872)	1.078*** (3.154)	0.813** (2.251)	1.119*** (3.714)
<i>D<sub>Asia</sub></i>	0.009 (0.052)	-0.199 (-1.221)	1.025*** (7.353)	0.042 (0.231)	0.287 (1.099)	0.344 (1.340)	0.691*** (3.834)
<i>D<sub>Australia</sub></i>	-0.899*** (-4.188)	-1.461*** (-8.749)	1.610*** (4.541)	-0.139 (-0.514)	-0.591 (-1.530)	-0.564 (-0.491)	3.254*** (3.830)
<i>D<sub>State</sub></i>	0.727*** (7.147)	0.561*** (4.958)	-0.630*** (-5.806)	1.051*** (9.695)	0.840*** (6.778)	0.750*** (4.159)	1.095*** (13.608)
<i>D<sub>Joint</sub></i>	-0.538*** (-3.250)	-0.479*** (-2.712)	-0.698*** (-4.578)	-0.008 (-0.050)	-0.498** (-2.623)	-0.820** (-2.318)	0.356 (1.376)
$\bar{R}^2$	0.824	0.813	0.910	0.790	0.748	0.747	0.948
Number of observations	43	43	31	42	38	39	32

**Note:** The estimation method is the two-stage least squares method. \*\*\*, \*\* and \* denote significance at the 1, 5 and 10 percent level, respectively. Heteroscedasticity robust *t*-statistics are reported in parentheses.

possess high expectations before joining Chinese banks often find that the power structure and aims of organizations are quite different from what they are used to. Thus, they are puzzled about the way that Chinese banks operate. We believe that the unequal satisfaction ratings are important because many FSI have recently sold their joint-venture shares in either the banking or the insurance sector. Although many reasons could explain such

sales, one of them might be asymmetric satisfaction. This concern might be mitigated only when the two parties gradually understand more about each other and are able to adapt to the different corporate cultures for the sake of a harmonious and productive partnership.

## VII. Conclusion

This paper explores how the mutual satisfaction of Chinese banks and their FSI affects the performance of the former, and identifies the determinants of satisfaction of both parties. The conclusions are as follows.

Although this paper does not study the cause-and-effect relationship between satisfaction and profitability because of limitations on data availability, we find that satisfaction affects profitability, but not vice versa. That is, the more satisfied the foreign investors are toward Chinese banks, the better the performance of the Chinese banks. This result is particularly true for the following indices included in the survey: general cooperation, corporate governance, management framework and the overall index. In addition, the satisfaction of Chinese banks toward foreign investors has a positive effect on their own performance, although the effect is less pronounced.

The profitability of Chinese banks seems to have no influence on the satisfaction of either party, whereas foreign banks with higher equity ratios show lower satisfaction levels toward Chinese banks, and also receive lower satisfaction scores from them. In contrast, foreign banks with higher loan–deposit ratios demonstrate higher satisfaction levels toward Chinese banks and also receive higher satisfaction scores from them.

The regions of FSI origin have significant effects on satisfaction rates. American banks assign the highest satisfaction rate to Chinese banks, but receive the lowest satisfaction rate from Chinese banks. In contrast, Australian banks assign the lowest satisfaction rate to Chinese banks but receive the highest satisfaction from Chinese banks. Satisfaction shows a regional asymmetric effect. Asian FSI are the only exception.

The type of Chinese bank is also important in determining satisfaction level. State-owned banks give the highest satisfaction ratings to FSI and receive the highest satisfaction ratings from their FSI. Joint-stock banks grant higher satisfaction scores to FSI than city banks. However, they receive lower satisfaction rates from FSI than city banks do.

The present study helps to evaluate the effects of the policy to introduce FSI in China. Higher levels of mutual cooperation satisfaction increase profits; thus, studying ways to improve cooperation could be crucial to the policy associated with the opening of Chinese banks to FSI. As Shen *et al.* (2009) suggest, possible steps might include conducting periodic reviews on cooperative effects, setting up a system of rewards and penalties, and

providing resources for training international staff. Furthermore, the regions of origin of FSI, types of local banks, and financial characteristics of local banks and FSI are all important determinants of mutual cooperation satisfaction. These results can provide a roadmap for Chinese local banks and potential foreign investors when considering future partners.

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