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Challenging Confucius: Western banks in the Chinese credit card market

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Abstract China has commanded a great deal of interest from virtually all U.S. business sectors. The Chinese credit card market is now particularly intriguing for Western banks. This article examines the strategic minefield that Western banks must navigate as they attempt to compete in the Chinese credit card industry. As an example, Bank of America (BOA)—fresh from purchasing a 9% interest in China Construction Bank (CCB) a few years ago—is now contemplating a joint venture with CCB. The new company will be tasked with leading the Chinese credit card market. Specifically, two questions are addressed: (1) whether the Chinese banking market is a sound option at this time; and (2) whether China affords an optimal environment for credit. The analysis yields several strategic lessons, and encourages caution on the part of Western bank executives as they enter the Chinese market. In particular, BOA officials must appreciate the timing of their joint venture's evolution. Additionally, BOA officials should strongly consider financial ventures other than credit, as Chinese culture should prove particularly resistant to serving as a profitable customer base in the short- and middle-timeframes.

1. A risky venture

In its 2005 annual report, Bank of America (BOA) announced that it hoped to establish a joint venture (JV) with China Construction Bank (CCB) to provide consumer credit cards in China (Bank of America, 2005). With China in general holding great promise, and having purchased a 9% stake in CCB, BOA's announcement seemed to be a logical and reasonable strategic aspiration. However, several issues now confront BOA as it contemplates the new venture. Economists and financial commentators question the strength of China's banking system, while others observe that China's population is strongly predisposed to saving income rather than spending it.

2. Key strategic decisions

2.1. Is the Chinese banking market a strategically sound option for BOA at this time?

Many observers are more optimistic than ever that the Chinese banking industry is ripe for foreign

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investors. Until recently, the history of China's banking system was a rocky one, to the point of discouraging significant foreign investment (Tinghuan, n.d.). Some, including Michael Overmyer of the *China Business Review*, believe that 2006 could be viewed in retrospect as a watershed year for China's banking system (Overmyer, 2005). By December 11, 2006, China was obliged under its World Trade Organization (WTO) membership to pursue several reforms in its banking sector, including the removal of all geographic and customer restrictions on local currency businesses and the elimination of restrictions on the ownership, operation, and operational form of foreign-invested banks (Overmyer, 2005). Because one of the most important facets of successful foreign investment in China is the construction of alliances (Chang, 2006), many American firms—including banks—now feel pressure to build networks and enter into joint ventures with indigenous companies at the earliest possible juncture. It should be noted, though, that China is not obliged to remove all restrictions on foreign investment and banks (Overmyer, 2005), and the Chinese government is highly unlikely to do so voluntarily.

The United States government is now working directly with the China Banking Regulatory Commission (CBRC) in promoting development of the Chinese banking system (U.S. Trade and Development Agency, 2005). This fact, together with China's existing credit card environment, has bolstered U.S. financial firms in seeking out opportunities in the Chinese market (Table 1).

Not all assessments of the Chinese banking industry are so optimistic, however. Nonperforming loans are staggering, with an enforcement regime that leaves much to be desired (Ping, 2003). Other serious challenges include the quality of joint stock banks, the loan classification system, tax policies, unfavorable treatment of banks under the bankruptcy code, and poor corporate governance and management (Ping, 2003). The legal regime, moreover, could change at a moment's notice, and in directions unfavorable to Western banks. As recently as 2005, for example, a seriously-considered set of rules was proposed within the CBRC that would have "encouraged" foreign banks to "establish branches in the poorer central and western regions of China to 'reduce excessive competition between foreign and Chinese banks' in the more prosperous eastern provinces" ("New Rules," 2005). As stated by Howson and Ross (2003):

> Though WTO entry promised improvements in the regulatory landscape for foreign banks in China, subsequent...regulation has burdened foreign banks with significant constraints on their activities in China. Thus, though geographical restrictions on renminbi (RMB) business by foreign bank branches were to be removed completely by December 11, 2006, foreign banks will still face burdens in establishing branches in China, including onerous representative office seasoning requirements; branch-level capital reserve, liquidity, and deposit requirements; foreign exchange deposit/foreign exchange asset ratio limitations; and lengthy branch application procedures.

2.2. Does China afford an optimal environment for private credit?

Assuming that BOA wants to expand in the Chinese market, the issue of what type of business to do in China is of paramount importance. To date, BOA envisions bringing one of its 20th century innovations in the U.S.—the credit card—to Chinese consumers.

Many observers predict that China's credit card industry will expand to include 100 million card holders within the next 5 years, more than four times the 2002 statistic ("Credit Cards," 2002). Some American banking majors—including Citibank—have already introduced credit cards in China, with the ultimate goal of carrying out local currency transactions for Chinese customers. Because only a fraction of the country's 1.3 billion people have credit cards, foreign financial firms have viewed the credit card industry as having high growth potential, but "the eventual scale of such business will depend on regulatory reforms" ("Citigroup's Deal," 2003).

Table 1. Chinese card data

Year	1995	1996	1997	1998	1999	2000	2001	2002
Number of cards (millions)	14	42	72	116	180	277	383	500
Transaction value (billions RMB)	961	1038	1297	1320	2422	4530	8430	11560
ATM (units)	7051	9941	18346	20634	26424	38000	n/a	n/a
POS (units)	48384	99716	131924	180272	223509	290000	n/a	n/a

Source: Worthington (2005)