

CITIBANK, N.A., IN CHINA

Larry Li and Adrienne Young prepared this case under the supervision of Professor David W. Conklin solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

Ivey Management Services prohibits any form of reproduction, storage or transmittal without its written permission. Reproduction of this material is not covered under authorization by any reproduction rights organization. To order copies or request permission to reproduce materials, contact Ivey Publishing, Ivey Management Services, c/o Richard Ivey School of Business, The University of Western Ontario, London, Ontario, Canada, N6A 3K7; phone (519) 661-3208, fax (519) 661-3882, e-mail cases@ivey.uwo.ca.

Copyright © 1997, Ivey Management Services

Version: (A) 2010-02-04

We want to be totally global and totally local.

— John Reed, Chairman and CEO, Citicorp¹

CITIBANK AT A CROSSROADS

In 1997, Citibank was still at an early stage in its China entry strategy. It was one of the strongest foreign banks operating in the People's Republic of China (PRC), but as a foreign bank it had only limited market access. It was licensed only to provide corporate banking services, and only to foreign-invested enterprises. It was licensed to operate branches in only three of the 24 Chinese cities open to foreign banks. In order to grow beyond these cities, and to expand from foreign corporate banking to the large and potentially lucrative domestic retail banking business, Citibank needed licenses from the central bank. And by preference, Citibank's China executives would have liked Citibank to be among the first foreign banks to get those licenses.

The bank's senior China staff knew that the People's Bank of China (China's central bank, or PBOC) would eventually open the China market to foreign banks, but they also knew the process would be slow. On the one hand, the PBOC was under pressure from the People's Congress, which hoped that commercializing and opening its banking sector would strengthen its bid for admission to the World Trade Organization. On the other hand, China's state banks were in appalling shape. Generally, they were run by bureaucrats, up to their knees in bad debts, still required to provide cheap funding to nearly bankrupt state enterprises, and unable to set their own deposit and interest rate levels. It might take them years to become properly competitive, and meantime it was up to the PBOC to see that strong foreign competitors like Citibank had no chance to bulldoze them out of the market. Mr. Chris Tibbs, the vice-president and head of corporate finance of Citibank's Chinese branch, was optimistic on this front. "The banking system in China is evolving faster than most other countries", he said in August 1997. "Generally speaking, the bureaucrats who are responsible for the financial market reforms are quite intelligent people. They know

¹ Bryan Batson, "Thinking Globally, Acting Locally," *China Business Review*, 20, no. 3. (May/June 1993): 23-25.

very much where they want to go. They are more efficient than most of the countries I have worked in (Japan, North and South America, and Hong Kong). I am optimistic that things will work out. PBOC operates in a very cautious but intelligent manner. The PBOC will not hold off our expansion. Actually, it is encouraging us to expand: it wants to use Citibank as a tool to force Chinese banks to become more competitive as soon as possible.”

Though Citibank’s senior China executives had worked hard to develop a good relationship with the PBOC, and were clearly positive about that relationship, they may also have had reason to be concerned. Citibank was one of the most powerful foreign banks in China, and given its deep pockets and obvious interest in emerging markets, the one that posed the most obvious competitive threat to China’s struggling domestic banks. Should the PBOC feel that Citibank was too large, too ambitious or too successful in China, it might respond by braking Citibank’s China expansion plans and give early licenses to smaller, less threatening foreign banks instead.

How could executives ensure that Citibank would maintain its first mover advantage in China? The Citicorp board wanted to see Citibank develop a major presence in retail banking. How could China executives ensure that Citibank would be among the first foreign banks to enter the domestic retail market? The most obvious option was a PBOC-sanctioned joint venture with a local bank, but Citicorp’s chairman would almost certainly be opposed to the idea. Citibank didn’t do joint ventures unless forced. Were there any viable alternatives? And if, despite Citibank’s best efforts, PBOC opened China’s retail market to other foreign banks before granting licenses to Citibank, how could Citibank establish its dominant position in a retail market?

CITIBANK WORLDWIDE

Citibank, N.A. was the second-largest bank holding company in the U.S. in 1997 and was sole shareholder of Citibank, N.A. in China. The bank was significantly more international in scope than its international competitors: In 1997 it operated more than 3,400 locations in 98 countries, and, as recently as 1995, it derived 58 per cent of its net income from foreign operations. The bulk of that income came, furthermore, from its emerging market franchise². The bank earned a net income of US\$4.5 billion in 1996, with \$294 billion in assets and \$28.9 billion in capital.

Citibank had not always been a world-class success story, however. The bank suffered through a very difficult period in the late 1980s and early 1990s as a result of its decentralized decision-making structure and what *Euromoney* called a “near fatal brush with commercial real estate lending” in the U.S.³. Thus, Chairman and CEO John Reed spent much of the early 1990s engineering the bank’s recovery — a brutal but apparently successful process. One of his most well-known re-engineering efforts was the G-15. In 1993, at the height of the bank’s real-estate lending crisis, he created a committee of the bank’s top 15 business managers, who all reported directly to him. He required them all to fly to New York once a month for meetings that lasted an entire day and sometimes two, and were frequently highly confrontational, punishing all the managers involved, but analysts said it worked. By centralizing the decision-making in New York and forcing his managers to fight him on every major strategic decision, he managed to repair the bank’s balance sheet, rebuild its tier-one capital and restore its credit ratings by 1996⁴. Although the G-15 structure was modified later, decision making was still much more centralized in 1997 than it had been in the 1980s.

² *Lehman Brothers Inc., Citicorp -- Company Report, December 12, 1996.*

³ *Peter Lee, “Reed Reshuffles the Pack,” Euromoney, April 1996, 34-39.*

⁴ *Lee, “Reed Reshuffles the Pack.”*

Another change Reed made was a re-orientation of the bank's strategic focus. Reed believed that Citibank's strategic advantage was in its international operations: global reach, local ties. The businesses where this advantage would be best leveraged, he hoped, were global relationship banking and global consumer finance. His focus after 1995 was, therefore, developing the bank's advantage as an international operation and, with it, developing those two lines of business. This focus would almost certainly drive all strategic decisions through the year 2000, including Citibank's decisions with regard to its China presence.

CITIBANK'S COMPETITIVE ADVANTAGE: ITS GLOBAL NETWORK

When a multinational company wants to enter an emerging market it calls its lawyers, its accountants, the embassy and Citibank. — Shaukat Aziz, head of Asia/Pacific global finance operations⁵

Citibank executives, as well as most banking analysts, would probably agree that Citibank's only true and sustainable advantage in the 1990s was its sprawling global network which was important in serving its powerful list of corporate banking clients but crucial, too, in developing its consumer franchise in lucrative offshore markets.

This network, moreover, was extraordinarily strong in the emerging markets which were most attractive to Citibank's key corporate banking clients and to its own consumer finance division.

To provide an idea of the extent of Citibank's presence in and commitment to emerging markets at that time, Citicorp annual report statistics show that, while 58 per cent of total profits were provided by the bank's ex-U.S. operations in 1995, very little of this came from the developed world. In fact, slightly more than 47 per cent of total profits in 1995 came from the bank's 76-country emerging markets franchise. The Asia/Pacific region (where Citibank was particularly strong and which was considered a division of the emerging markets sector) brought in 23 per cent of the bank's net profit in that year.⁶

How had Citibank developed its emerging markets advantage?

Time and Experience

Citibank had been in some of these markets for nearly 100 years. Where this had not been the case, Reed clearly believed in the value of first mover advantage, and had worked to ensure that Citibank was usually among the first foreign banks to get its foot in any emerging market door. The bank's relative experience in these volatile markets created a level of operational expertise that, in times of turbulence, other banks found difficult to match. This was a particularly valuable asset in attracting and keeping important multinational accounts.

Localization and Commitment

Citibank worked hard to develop close ties with the community and with the local central bank. Ninety-five per cent of Citibank's jobs held outside the U.S. in 1997 were held by locally hired staff. The bank had

⁵ *Lehman Brothers Inc., Citicorp -- Company Report, December 12, 1996.*

⁶ *Lehman Brothers Inc., Citicorp -- Company Report, December 12, 1996.*

a well established reputation for commitment, too, which made them popular with governments: Unlike some other banks which moved into countries on the expectation of brisk profits and then moved out again when they were slow to materialize, Citibank moved in early with intent to stay. Executives (including John Reed) routinely emphasized the bank's ability and eagerness to help the local financial services industry grow. Employees were seconded to central banks. Technology was transferred. Locals were trained.

Citibank was not above currying political favor either: In Taiwan, for example, the bank "wowed Taipei" by bringing former U.S. President George Bush and former British Prime Minister Margaret Thatcher to visit in the 1990s. This seems to have worked particularly well. Rival bankers said, after that, Citibank got "just about anything they wanted from the central bank."⁷ Someone, somewhere inside Citibank was almost certainly wondering how this model could be made to work for the bank in mainland China in 1997.

Technological Superiority

According to a Lehman analyst, Citibank was "ahead of the curve" with respect to technology and financial innovation⁸ in the mid 1990s. Judging from the number of awards the bank won in 1996, this was not an uncommon view. Citibank was broadly perceived to be very strong in corporate banking services ranging from foreign exchange to cash management, debt capital markets to derivatives. And if this was the case in the U.S., it was even more obvious in emerging market nations where competition was less well developed, financial systems less evolved. It is also the reason Citibank won numerous awards as best bank overall: best emerging markets bank, best Asian bank, best foreign bank in China, best foreign bank in a number of other emerging markets⁹. In other words, Citibank could usually provide better corporate banking service than local banks in many of its markets, and competitive service in more markets than any of its "foreign bank" competitors.

Human Resources Practices

According to Chris Tibbs, human resources development was one of the bank's most pressing issues in China. "The most challenging thing for us today is the human resource side of our business. Normally, a person needs to have about seven years of experience before he/she can be a capable manager. We only started branch banking activity in China three to four years ago, so we have trained local people to be a successful managers for only three or four years." Despite this, the bank's human resources practices were broadly perceived as a powerful competitive advantage, in China and throughout Asia. Analysts in China said that Citibank people were frequently poached by other banks. Tibbs confirmed this, noting that the bank's counter-strategy (salary, environment and opportunity) was helpful in holding staff, and even in bringing them back. "As a matter of fact," said Tibbs, "our people who went to work for ABN-Amro want to return to Citibank. We are the college of banking and the best bank in the world."

Accounting Practices

The bank also had an advantage in Asia in its audit and accounting practice. This was particularly true in China, where Citibank was the bank the PBOC chose to work with to improve internal auditing within the

⁷ James Peng, "U.S. Giant Shakes up Taiwan Banking, Eyes China," *BC Cycle*, 17 July 1996.

⁸ Lehman Brothers Inc., *Citicorp – Company Report*, December 12, 1996.

⁹ Titles awarded by *Euromoney*, *Corporate Finance*, *Institutional Investor*.

domestic banking system. As of 1997, the PBOC was actually using Citibank's internal auditing standards as a guide for its own, and extending that standard to other Chinese banks. According to Chris Tibbs, in fact, the PBOC was so pleased with Citibank's recommended internal control system that they used it to audit the bank's new Beijing branch only six months after opening. "After our branch in Beijing had been open for about six months, we received a message from PBOC that it was going to audit us," said Tibbs. "It seemed strange that we had just been working for six months and it wanted to audit us. It turned out that it was because PBOC wanted to test its team of auditors, who were trained by us. This was the first time that Citibank was tested by its own students. After the team of auditors went through the auditing, Citibank suggested to them where they could possibly improve." Analysts wondered if, in China, this advantage was a sustainable one.

THE CITIBANK STRATEGY

Focus on What We're Good At: Global Relationship Banking and Consumer Finance

Having identified those basic strengths, Reed defined a strategy in 1995: Build on what the bank was already good at and on what was already profitable. And, as many analysts pointed out at the time, Reed's plan was much more about exclusion than most. As Euromoney put it in 1996, the strategy was "as much about what (Citibank) won't do as what it will do."¹⁰ Thus Citibank was categorically uninterested in insurance or global investment banking. It wasn't interested in equities and it wasn't interested in lending on a large scale. If it was active in those areas in the past, it had generally been quick to get out them, both domestically and internationally. And this would continue to be the case, according to the Reed plan, through the end of the century.

Global Relationship Banking (also known as GRB)

In focusing on the top 1,400 multinationals — most of them pursuing aggressive overseas growth strategies — Citibank was "serving global companies globally,"¹¹ an area where it had a distinct competitive advantage over both domestic and "foreign" banks in virtually all of the most attractive emerging markets.

In China, Citibank also had a strategy for targeting strong state-owned enterprises. "Our strategy," said Chris Tibbs, "is to identify 10 industries which would develop the fastest in a country, and target profitable companies within those industries. We are different from other banks in that we choose companies not only based on their numbers on the financial statements, but also the industrial sectors they are in, and the qualities of the management team."

In order to serve these customers seamlessly, each major Citibank GRB client had, by 1997, a "team" of its own. Bankers were encouraged to think of themselves as, for example, "on the Motorola team" instead of "in foreign exchange" or "from the HK office." And although, traditionally, large banks might focus on the higher-profile activities of lending and underwriting, Citibank focused primarily on profits to be made from lower-risk day-to-day transaction banking: fund transfer, custody, cash management, foreign exchange and securities trading. Other corporate banking services (trade services, lending and capital markets) were emphasized less heavily than in the past.

¹⁰ Lee, "Reed Reshuffles the Pack."

¹¹ Lehman Brothers Inc., Citicorp -- Company Report, December 12, 1996..

In the “Asian model” Citibank executives would apply in thinking about their China strategy, the GRB franchise usually represented an important platform, allowing Citibank to embed itself in new economies, hiring locally, developing a relationship with domestic regulators and (this was an emerging idea at Citibank) beginning to serve ambitious local companies as well as Western multinationals. With licenses and regulatory relationships in place, the consumer bankers could then move in,¹² offering whatever range of retail banking products was appropriate, marketing *Citibanking*® as the country’s new premium banking product.

Global Consumer Finance

What Citibank aimed to provide worldwide was a one-stop shop for retail financial services. This would mean uniform service wherever consumers choose to bank, and with the convenience and reliability emerging markets clients probably associated more closely with their local McDonald’s than with the kind of banking services they were receiving from their domestic banks. Citibank charged a premium price for these services but expected that, usually, the internationally-minded and newly wealthy business elite in these nations would be willing to pay more for first rate banking services.¹³ Income statement figures suggest that they were. Consumer banking (which John Reed established at Citibank in the 1970s) was the largest and fastest-growing part of the bank by the mid-1990s,¹⁴ supplying 48 per cent of its earnings in 1995.

What were the advantages fueling consumer banking growth in Citibank’s emerging markets? Technology and first mover advantage, to begin with. But Citibank executives believed that one of their greatest assets in building consumer business was the Citibank brand.

Marketing the Experience: Citibanking®

In emerging market countries like China, Citibank had the capacity to develop what marketers like to call “strong brand equity.” It had cachet as an overseas bank. It had or could develop a reputation as a bank that provides superior service to those with money. And those who had money (who were increasing in number in these countries, and who might already have had corporate banking relationships with the bank) were generally pleased pay a premium for the level of reliable service and convenience — and the level of prestige — that they could only get from banking with Citibank. Citibank marketed its package of consumer banking services as an experience: “*Citibanking*®.” This branding strategy was not yet an advantage in China as Citibank was not allowed to provide retail banking services there. That was, however, probably only a matter of time. Brand equity was perceived to be a great asset elsewhere in Asia, where Citibank’s consumer banking business was growing at a very healthy clip. The importance of brand image to Citibank’s consumer banking franchise should not be underrated, therefore, and would certainly be a factor in any discussion of joint ventures or strategic acquisitions.

¹² Kenneth Klee, “Brand Builders,” *Institutional Investor*, March 1997, 89.

¹³ Klee, “Brand Builders,” 89.

¹⁴ Lee, “Reed Reshuffles the Pack.”

Citibank's Joint Venture Strategy: A Few Final Comments

We are accelerating our plans to get fully engaged in our business directions ... to fund the expansion of our franchise in the emerging market.

— John Reed¹⁵

Citibank was strongly averse to joint venture relationships, entering into such agreements only when forced by central bank authorities.¹⁶ Citibank operated in China, as in most countries, as branches of the parent, not subsidiaries. Chris Tibbs, agreed with this negative attitude towards joint ventures (JVs). “We recognize that most JVs do not last very long,” he said in August 1997. “JVs give an institution a short-term advantage, but not long term benefit. A JV in China would be an expensive practice. We do not think that we need to do a JV in China. Up to three years ago, many institutions favored JVs. Now they realize that the environment in China is such that it is unnecessary for them to do JVs in order to get business. Today, foreign institutions are looking for majority shares of the partnership, or even 100-per-cent ownership. The expansion of Citibank in China may be possibly through merger and acquisitions, instead of joint ventures.” This made sense given the value Citibank placed on its own brand name, as well as the fact that, in the emerging nations where it was expanding most vigorously, the bank served its target clientele — top tier multinationals and later high-income retail clients — better than local banks were generally able to do.

The door was not, however, closed to the concept of growth through acquisition. John Reed suggested in 1996¹⁷ that he was more comfortable with the concept of strategic acquisition than he had been in the past, as long as such an acquisition would build up one of the bank's key lines of business. The idea of an acquisition in China offered, at the very least, an opportunity to make another positive impression on China's central bank, the People's Bank of China. It might also impress Citibank executives as a way to reinforce their image as a committed foreign presence, deserving of access to the retail market. It would certainly, however, create branding issues. Thus, if Citibank's China staff were to propose an acquisition, they would do so with the expectation of significant concern from the Citicorp board.

For Chris Tibbs, the acquisition of an existing Chinese financial institution was not a likely scenario, or even a desirable one:

Acquiring a financial institution in China is not only not on our 'radar screen,' it is not something which I could see the government allowing anytime soon. Further, the time, resources, and market momentum lost in repairing someone else's wrecked bank (portfolio) is so significant that this is not one's rational dream of how to get ahead fast.

CITIBANK'S SUCCESS IN ASIA

Earnings in the region grew in line with the economic boom of the 1980s and 1990s: Net income from Asian operations grew about 30 per cent annually between 1983 and 1995¹⁸ and Reed had been happy to

¹⁵ Citicorp first quarter results from *Business Wire*, April 15, 1997.

¹⁶ The only joint venture banking relationships Citibank had been involved in during recent times was a joint venture branch with the Bank of Hungary (Citibank re-acquired the last of the central bank's shares in 1995 and presently owned 100 per cent of the branch) and the Saudi American Bank, a joint venture bank with the Saudi central bank.

¹⁷ At his December 1996 meeting with equity analysts, quoted in many analyst reports on Citicorp, including the Merrill Lynch report of January 24, 1997.

¹⁸ Batson, “Thinking Globally, Acting Locally,” 23-25; Lehman Brothers Inc., Citicorp -- Company Report, December 12, 1996.

invest resources there as a result, even when slashing in other parts of the world. Growth appeared to be leveling off by 1996, however,¹⁹ in line with the slowdown in GDP growth in most Asian markets. Citibank may have become slightly less willing to invest in the region as a result, shifting attention, perhaps, to Latin America, where growth and profit potential were somewhat more boisterous.

CITIBANK IN THE PRC

Citibank had a long history in China, too, suggesting a deep institutional understanding of the nature of the market. The following is a brief timeline, indicating some of the bank's major China milestones.

1902: Citibank opened a branch in Shanghai, making it the first U.S. bank to establish operations in China.

1930s and 1940s: Citibank was one of the country's major foreign banks during this period, operating 14 branches in nine cities.

WWII: Citibank's branches were all closed down or taken over by the communist government.

1984: Citibank opened its first office in Shenzhen and its first rep offices in Beijing and Shanghai. China had just allowed foreign banks to establish rep offices and, as usual, Citibank was one of the first banks in.

1991: People's Bank of China (PBOC) upgraded Citibank's Shanghai rep office to full branch status.

1993: Citibank moved its China headquarters from Hong Kong to Shanghai, one of only two banks to do so. Please note, however, that this appeared to have been a somewhat cosmetic move. Citibank's North Asia consumer-finance operations were based in Taipei, which Citibank viewed as a "launch pad" for the China market²⁰. Corporate banking activity — syndicated lending, for example — was still based in Hong Kong.

1995: PBOC upgraded Citibank's Beijing rep office to full branch status.

December 1996: PBOC granted four foreign banks the right to conduct business in RMB (Renminbi, also known as "yuan," China's domestic currency). Citibank was among these banks. There were numerous restrictions, including requirement that all affected banks move their Shanghai branches to Pudong, Shanghai's new financial district.

February 1997: Citibank moved its Shanghai branch to Pudong. The district was still under construction, and Citibank was the first foreign bank to make the move. The "old" branch in the Puxi district was downgraded to sub-branch status.

August 1997: Citibank now had the largest network among American banks in China, with branches in Beijing, Shanghai and Shenzhen, a sub-branch and national head office in Shanghai as well as rep offices in Xiamen and Guangzhou²¹.

¹⁹ *Lehman Brothers Inc., Citicorp -- Company Report, December 12, 1996.*

²⁰ *Peng, "U.S. Giant."*

²¹ *"Citibank Gets RMB Business License," BC Cycle, 31 December 1996.*

CITIBANK'S POSITION IN THE PRC IN 1997

Profits are “okay but not spectacular.”

(China is) a priority market for us and for many foreign direct investors. Now that we've put our network in place, we are ready to build the franchise. And we think we can help China as it goes ahead with economic development. At the same time, we want to help the country modernize its banking sector.

— John Reed, at the opening of the Beijing branch in 1995²²

Hard Currencies: Moderately Profitable, Lots of Potential

As of June 1997, Citibank had branches in Shanghai (where it was one of about 50 foreign banks), Beijing (where it was one of about 10) and Shenzhen. Like other foreign banks in the PRC, Citibank was permitted to engage in:

1. hard-currency transactions (deposits, loans, etc.)
2. exchange of foreign currencies
3. buying and selling of stocks and securities

Statistics available for the market as a whole suggest that the China branches of foreign banks were performing, at the minimum, respectably. During the first four months of 1996, for example, the EIU reported that foreign financial institutions in China booked US\$110 million in after-tax profit on total registered assets of US\$24.6 billion. They had a large share of Shanghai's banking business, indicating their popularity with the local Foreign Invested Enterprise (FIE) community: Holding 20 per cent of the city's forex balance they did 40 per cent of the loan business, 35 per cent of the foreign trade account business.²³ Lending was very impressive as well: US\$16.6 billion — though this probably included syndicated loans to Chinese government borrowers (usually booked through Hong Kong) as well as loans granted to FIEs and booked through PRC branches.

Analysts said at the time that there was still considerable potential for growth in lending to the FIE community and, due to the extraordinary demand for infrastructure in China,²⁴ even more potential in lending to Chinese borrowers. To give an indication of the scale of business available to banks willing to develop relationships with Chinese borrowers, the State Planning Commission (which regulated offshore borrowing by Chinese corporate and state issuers) announced in early 1997 that foreign currency borrowing would total US\$18 billion that year, up 63 per cent by comparison to 1996.²⁵ According to Chris Tibbs, however, this was not a particularly attractive market. The government exerted tight controls over total offshore borrowing and competition for business was reducing the lending margins. From February to August of 1997, for example, intense competition had tightened loan spreads by an average of 40 basis points. Tibbs felt that, in this environment, there wasn't enough money to be made in lending. And while some banks — the Japanese houses, for example — were having difficulty transforming their

²² “Citibank Willing to Wait for China Banking Reform,” *Reuters*, October 30, 1995.

²³ *Economist Intelligence Report, Financing Foreign Operations: China 1997*, 32.

²⁴ *The World Bank estimated in 1996 that Asia would need about US\$1.5 trillion to fund its infrastructure needs for the next 10 years. A hefty chunk of that would go to China, and much of the money would, by necessity, be borrowed from foreign banks.*

²⁵ *FFO*, 44.

businesses, Citibank's response to the situation was to focus on providing fee-based transactional services: currency trading, advisory services, even underwriting and placement for corporations needing money.

Old-Fashioned Lending or Fee-Based Business?

Citibank's Tibbs believed that China's banking system would evolve more rapidly than most people expected or realized. And in this context he believed that Chinese state banks, because of their increasingly competitive attitudes and their enthusiasm for fee-based income, would become increasingly important competitive threats in the areas Citibank had targeted as most attractive.

We are facing threats from Chinese banks, which are fast in becoming very competitive," he said in August 1997. "We consider ICBC and China Bank of Communication the most competitive for us. ICBC, for example, is huge. It has not only an enormous number of branches, but also the most advanced MIS (Management Information System) in China. These give ICBC very clear competitive advantages over other Chinese banks. To give an example of the new competitive strength of Chinese banks, six months ago, it took about two weeks to transfer money from Beijing to Shanghai. Now it takes only two days. Yesterday we received a request from one of our clients, asking why we could not do it in one day. Considering it still takes two weeks for the similar money transfer in Italy or India, China's progress is very impressive. A few years ago, ATM machines were rare in China. Today they are everywhere.

As noted above, Citibank was also in 1997 one of only a few foreign banks permitted to deal in RMB. Was this strategically important? Was early access to a license a sustainable competitive advantage?

RMB Banking: Early Lead Gains No Sustainable Advantage, but the Market Had Potential

Unlike most of the 150 or so other banks in China, Citibank was allowed to engage in RMB transactions early in 1997. On December 23, 1996, the Shanghai branch of PBOC granted four foreign banks permission to do local-currency business in China. Citibank was one, and the others were HSBC, IBJ and BOT-Mitsubishi. This put Citibank in a somewhat privileged position because while this was something of a "test run" from China's point of view, by June 1997, only eight foreign banks (the other four are Standard Chartered, Sanwa, DKB, BOJ) had been approved to deal in RMB.

This looked, at first view, to have been a much more substantial competitive advantage than it really was. Independent analysts said at the time that none of the banks given RMB rights were likely to make "real inroads" into China's coveted RMB-banking market, primarily because the restrictive measures were "greater than most people expected."²⁶

These restrictions, established to keep foreign banks from competing with domestic ones, were as follows:

1. Branches dealing in RMB must all be in the Pudong district of Shanghai, (the city's new financial district).
2. They could accept RMB deposits from foreigners and foreign-invested enterprises (FIEs) but not from local companies or Chinese individuals.

²⁶ Pamela Yatsko, "Strings Attached: Foreigners Get Limited Entry into Renminbi Banking," *Far Eastern Economic Review*, January 16, 1997, 52.

3. They could make RMB loans and extend guarantees to FIEs and foreigners with offices in Shanghai, but not to the vast majority of local companies or individuals. They could, however, invest in RMB treasury and other bonds.
4. Total RMB deposits (liabilities) could not exceed 35 per cent of total foreign currency liabilities, excluding interbank deposits. Bankers considered this a very shallow deposit pool.²⁷ However, Citibank had a large foreign currency liability base, and so Tibbs felt that “this is in no way an impediment to our profitable growth.”
5. Banks could also borrow RMB on the local interbank market and could “when necessary” borrow from the PBOC (though details were not clear, regulations were somewhat vague, according to EIU’s FFO document, March 1997 and foreign bankers quoted in the Yatsko article). They must, however, lend at rates fixed by the PBOC, and as there was no interest rate swap market developed in China yet, this created the interesting question of how to hedge their interest rate risk on funds that were borrowed for purposes of on-lending.

As Tibbs explained:

The function of a bank’s treasury is to manage the inherent risk involved in funding assets with terms longer than the underlying liabilities (deposits and inter-bank funding). Seeking to match funds or eliminate this “exposure” would go a long way to reducing overall global bank profitability. . . . In any event, we are quite able in China to hedge foreign currency interest rate risk and provide these hedges to Chinese and foreign clients. (With local currency deposit rates at 3.0 per cent or less and PBOC-set lending rates at 9.18 per cent or more, depending on length of term, and with lending in local currency restricted by market convention — not regulation — to one year or less, there was very manageable risk in this situation.) Banks make money through arbitrage, not by avoiding it. . . . We help others to avoid it.

John Beeman, Citibank’s country corporate officer for China, clearly agreed with analysts’ assessment of near-term profit potential. He said in February 1997 that “on the scale (of Citibank’s local currency business), our expectation for this year is that it will probably be relatively modest.”²⁸

In the long term, furthermore, the eight RMB-licensed banks would probably not be able to hold on to their advantage. The purpose of this exercise from Beijing’s point of view was to be seen to be opening up the PRC’s financial system so as to qualify for admission to the World Trade Organization. The reforms would, therefore, continue (albeit as slowly as possible) and more RMB licenses would inevitably be doled out. On the other hand, because China had given what the EIU calls an “open-ended commitment”²⁹ to allow more widespread foreign bank participation in RMB business, banks now approved to deal in RMB could eventually look forward to a much larger market. There would be fewer restrictions on the kind of business they could go after and fewer restrictions on the cities in which they could go after it. So medium-term profit potential for Citibank and its competitors was still unclear, but given the size of the country and the promising growth rate on the GRB side (among both FIE customers and new local corporate clients), it probably looked very enticing indeed.

And though the domestic retail market was still apparently closed to foreign banks, Citibank’s retail banking franchise would be in an even stronger competitive position when the PBOC loosened its anti-competitive restrictions in that arena.

²⁷ *Ibid.*

²⁸ “Citibank Opens Branch in Shanghai’s Pudong: Reuters Asia-Pacific Business Report,” *BC Cycle*, 17 February 1997.

²⁹ *Economist Intelligence Unit, China/Mongolia Report, First Quarter, 1997*, 26.

While other foreign banks and investment banks were competing strongly for corporate business, Citibank had a somewhat clearer field on the retail side: better technology and service capacity than most of the domestic banks; better network and local feel than the other foreign banks; and a brand name that, though new to most Chinese, already had some exposure among the elite and a certain amount of prestige. If one coupled that with the potential of the Chinese retail banking market, abounding in new wealth and already exhibiting interest in Citibank's high end product line, one could, perhaps, paint a picture enticing enough to make John Reed smile. Possibly quite broadly.

Credit Cards: Not Likely in the Near Term

While credit cards were an important and lucrative part of the Citibank consumer banking lineup elsewhere in Asia, Mr. Tibbs said that if the retail banking market were opened to foreign banks, Citibank was not optimistic about the credit card business in China in the near term. Why? The Chinese government and the PBOC had great sensitivity toward inflation. The government believed, analysts said, that along with corruption, one of the contributing factors to the 1989 Tiananmen problem was out-of-control inflation. Thus, from the point of view of the government, inflation constraint was a very important goal. The prevailing view in 1997, furthermore, was that if China was to maintain its exemplary rate of economic expansion, the national savings rate (40 per cent) would have to be maintained. Encouraging borrowing — via credit cards, for example — would increase inflation and discourage saving. Thus, analysts suggested, it would not be in the best long-term interest of either the country or its financial institutions to encourage hasty development of a retail credit card market. So, while Mr. Tibbs said Citibank did not see any risk of out-of-control inflation or of consequent currency devaluation in the last years of the millennium, Citibank was unlikely to push the expansion of credit cards in the PRC market.

Overall, then, analysts believed that Citibank's greatest competitive threat came from China's state banks: modernizing fast and possessed of vast branch networks. Nevertheless, most believed that if Citibank were allowed reasonably early access to China's retail markets, its success in China was probably assured, just as it had been elsewhere in Asia. As far as the board of directors was concerned, it was the job of Citibank's senior executives in China to ensure that these things happened. Those executives knew, too, that John Reed and the board were waiting for an outline of their plans.