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Research on Risks of Chinese Commercial Banks' Independent Innovation

Mingyou Wang, Jian Gui & Jingting Ma
Shenyang University, Shenyang 110044, China
E-mail: gweijean@126.com

Abstract

Since the 90s in last century, financial innovation tends to be different under the condition of loose regulation and the revolutionary progress of information technology. The competition in the finance industry becomes severe and financial institutions lay more stresses on innovations, not only concerning the product innovation but also the services. However, risks come. The bankruptcy of many American financial institutions in last year deserves more attentions from China's commercial banks that should emphasize on financial innovations. Only by strengthening the internal and external supervision and regulation, can it reduce commercial banks' innovation risk.

Keywords: Commercial bank, Innovation risk, Management of risk

Since the 90s last century, commercial banks in western countries have paid more attentions on financial innovations that concern not only financial products but also financial institutions, financial system, and financial services. In a short period, these financial innovations have actualized better effects. In a sense, their independent innovations have been improved to a great degree. However, the financial crisis indicates that the commercial banks in western countries produce risks as they make innovations. They neglect innovation risks. As China's commercial banks learn innovation experiences from western countries' commercial banks and evaluate their innovation abilities, they should care about the control over risks. The independent innovation effect of commercial banks should exclude the expenses on risks. The stronger the ability of controlling risks is, the smaller the risk is, and the stronger the ability of independent innovation is.

1. The relationship between financial innovations and risks

The financial innovation concept is mainly derived from Joseph Schumpeter's economic innovation concept. Financial innovation means to change present financial system and adopt new financial tools in order to gain potential profits that can not be obtained by present financial system and financial tools. It is a slowly-continued development process driven by a desire for profits. The birth of new things is always accompanied with uncertainties and randomness. Risk is a byproduct of innovation. Financial innovation risks concern two aspects, namely the stock risk and the increment risk.

For the stock risk, financial innovation is the best way for improving the asset structure and defending risks. China's commercial banks mostly focus on traditional operations. Liabilities mainly locate on public deposits and savings. Assets are mainly loans for enterprises. However, the irrational loan structure, term limits, and rates structure lead to bad liquidity of loans. As a result, banks that mainly depend on interests from loans operate hard due to the poor-quality assets. These banks face higher risks. By developing new businesses, banks can speed up the circulation of capitals. On one hand, it can improve the safety of assets by higher profitability and liquidity. Then, banks can actualize the maximum effect of total assets. On the other hand, it can separate banks' assets as much as possible, which can help to escape from higher risks caused by centering in few customers, reducing banks' losses and improving banks' assets quality and governance level. Foreign financial development history also shows that financial innovation and exploration is the best choice for financial institutions adapting to the changeable economic environment and avoiding risks. For risks increment, it is better to develop financial innovation with a precondition of pre-analysis and prediction and strict control. As banks develop the money credit business, some unfavorable factors may cause that cashes fail to flow back or realize added value, which may lead to the loss of banks' assets. Therefore, to strengthen the risk management is the necessary and main content for banks' businesses. So, in making innovations, banks should take the development speed, the operational efficiency, and the risk prevention into consideration at the same time (Guangcheng Zhu, 2007, p46).

2. Problems in Chinese commercial banks' innovation

In China the financial innovation has started from the implementation of reform and opening-up policy. After twenty years, it has realized marvelous achievements, constructing a general central banking system, completing the institutional fame, forming a banking system that takes four state-owned commercial banks and more than ten stock commercial banks as the main body, and completing a financial corporate system in which multiple ownership structure and multiple financial institutions coexist. Meanwhile, loosen the market entrance standards for foreign bank branches and insurance industry, building an exchange market, and speeding up the opening-up process.

However, by reviewing China's financial innovation, we can find that there are four main problems.

Firstly, financial innovation lags behind economic development. The finance can not catch up with the development of economy, which results in that former regulations and system can not meet new conditions. After China's entry to WTO, few researches probe into new financial products. Systematic innovations lag behind. A so-called vacuum brand appears (Le Fu & Xianning Zeng, 2007, p78-79).

Secondly, financial tools are few. Presently, more innovations are for debts but less for assets. China's financial institutions focus on debts as they make innovations before. Because the loans operate in a seller market, where the competition is not so serious, financial institutions have no sufficient internal motivations and external pressures for innovations. The few financial tools and narrow financing channels lead to higher debts for enterprises and more pressures for banks.

Thirdly, information technology lags behind and fails to match up with financial innovation. As information network technology has been applied to the banking fields, China's commercial banks depend on information technology more and more. However, presently China's computer network technology can not catch up with world latest level. Commercial banks can not offer comprehensive electric information services for customers. Besides, banks' financial innovations can not cooperate with information technology well. It lacks a deepening data analysis marketing system (Ling Xiong, 2007, p65-66).

Fourthly, the personnel are not qualified due to the short of innovative consciousness and ability.

3. Risks for Chinese commercial banks' innovation

The blindness of financial innovation brings about risks. After the WTO entry, China speeds up the process of financial opening-up. In order to pursue for fast development, it is possible for the blindness of financial innovation, which may lead to uncertainty risks. At present, foreign banks' financial innovations focus on derivatives, financial futures, and financial business. China's financial industry lags behind foreign banks in many aspects, especially at the operational level. If introduce foreign banks' business mode, business way, and financial products blindly, it may exert negative effects on the innovation of China's grass-roots financial institutions, causing new financial risks, and affecting the steady operation and development of grass-roots financial institutions. In China, financial innovation is still at the imitation stage that does not care about profits. The popular joint insurance products have been stopped now, what means insurance companies could not estimate the risks and profits of these products precisely. As a matter of fact, these series of innovations are mainly from imitating foreign products simply. It may produce greater risks (Hongwei Zhang, 2006, p56-58).

Insufficient scientific and technological innovation generates electric risks. Today China's financial network develops well. Electric associated banks, payment and liquidity system, and bank credit register and consultant system begin to work mostly. But compared with foreign commercial banks' network construction, it still lags behind. Especially for online banks and telephone banks, there are greater potentials. In China, the development of capital market in some areas is imperfect. The internal management structure of financial institutions needs to be perfected further. And the equipped system, laws, and regulations are not perfect. Scientific and technological development may face higher risks in some areas. On one hand, computers may fail to operate properly objectively. On the other hand, crimes may take advantages over computers. Electric risks are systematic, concerning a large sum of money. Once there is an electric risk, the financial institution or even the whole financial industry may fall into a threat.

Unqualified personnel may bring about risks. Many factors contribute to the innovation risks. One of most important factor is the personnel. Today China lacks comprehensive talents who are familiarized with business and management, which causes a low development of financial institutions and poor innovation abilities. The potential risks are huge. It is impossible to guarantee the practical effect of financial innovation.

4. Measures for reducing risks for Chinese commercial banks' independent innovation

At present, it is an urgent to strengthen commercial banks' innovation risks management, guaranteeing the stable development of banks. In the innovation process, it is better to balance the market risks, the liquidity risks, and the credit risks. In the market risks aspect, shorten the combination term of monetary bonds, decrease the estimation value losses, and make best use of financial derivatives management transaction and non-transaction exchange risks. In the liquidity risks management aspect, pay more attention to and manage assets-liabilities term effectively, and exert the effects of currency swap on commercial banks' exchange businesses. In the credit risks management aspect, control the sum of loans, optimize the credit-loan structure, and enhance the risks supervision and entrance-exit mechanism.

Financial regulation and supervision is to implement restrictions on financial institutions' operations, prices of capitals, market entrance, and branches by legislation and management rules, aiming at stabilizing the whole financial system and insuring the safety of financial institutions' operations. Effective financial regulation and supervision can maintain credits, guarantee the stability of payment system, protect investors' interests, and driving the faire competition among financial institutions (Kunlin Zhu, 2009, p64-65).

4.1 Strengthen the exterior financial regulation and supervision

(1) Build and perfect the law support system for financial regulation and supervision. The effective operation of financial innovation and financial supervision should be guaranteed by perfect and transparent financial law system. Besides, it needs a set complete equipped implementation rules.

(2) Apply a strict market entrance system. The market entrance supervision is a powerful defense for preventing financial innovation risks. For the register and approval of financial innovation tools, trade institutions, exchange membership, and brokers, it is necessary to execute strict examination. Control financial innovation risks and guarantee the positive development of financial market.

(3) Build the financial innovation risks pre-warning system. By learning developed countries' successful experiences in reducing financial innovation risks, considering the practical conditions and risks features of finance industry in China, build a risks pre-warning system that is right for China's financial innovation.

4.2 Strengthen the internal financial regulation and supervision

(1) Build and perfect the internal control system for innovative financial tools trade. Establish the responsibilities and rights of innovative financial tools' participators. Build an information system to supervise, control, and manage the trade risks. Execute a comprehensive internal control and check. Exert the internal supervision function effectively.

(2) The financial innovation subject can determine the proportion of off-balance sheet business to total assets based on self scale, capitals, and capabilities. Control the off-balance sheet position. Enhance the statistical calculation and check on the off-balance sheet business. Once find problems in off-balance sheet business, manage it effectively and properly.

(3) Strengthen the management of outside branches. Establish the business scope and approval limits of foreign branches.

(4) Concerning the organizational arrangement, set up an independent risks management department, separating business innovation from risks management and decision properly, and achieving a balance.

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