Creating value in the coming decade.

A strategic view of banking and financial sector synergies in Greater China

Executive summary
The impressive achievements of China’s 30 years of reform have brought major changes in the roles of regulators, enterprises, financial service providers, investors, and consumers in the Chinese Mainland, Hong Kong SAR and Taiwan.

This summary is based on research detailed in an accompanying slide presentation. It is an analytic review of regulatory and market forces at work in the continuing development of the Chinese Mainland, Hong Kong SAR and Taiwan and then the development of these regions of Greater China in the broader context of Asia as an economic region.

Analysis of the macro-economic and sector developments of the different regions in Greater China makes clear that they share many common features, yet each has a very distinct profile. That distinct profile is reflected in things like the reaction of the Chinese Mainland, Hong Kong SAR and Taiwan to the global financial crisis, anticipated GDP growth rates, the structure of major corporations and enterprises, and the maturity of key service sectors. Looking at regulations, it is also reflected in currency policies, credit policies, tax policies, and labor policies.

We arrive at the viewpoint that the healthy development of the three economies in recent years is the result of two interacting forces. First, there is a long-term trend toward integration and harmonization, through mechanisms such as dual-listed stocks, banks from one economy opening branches in another, special agreements providing benefits and privileges between the economies, and opening of various investment windows across borders. These “vanishing border” trends create the opportunity for the economies to interact, share mutual strengths, and benefit from each other’s resources, markets, and growth.

In better examples of the long term trend toward integration, business innovators often are somewhat in the lead of regulators in finding new value creating activities from different consumer markets, financial markets, and regulatory regimes. In the Chinese Mainland and Hong Kong, for example, integration has been accelerated by interlinked investments and ownership, strategic partnerships, cross-border stock offerings, the series of Closer Economic Partnership Arrangement (CEPA) agreements, increasing use of the renminbi for trade and investment purposes, and fast development of communication and travel links.
There is also the opposite force-sustained differentiation of each system that leads to specialised roles in the overall development of China. Formalised between Hong Kong and the Chinese Mainland as “One Country Two Systems”. In practice a wide range of different monetary, tax, regulatory, commercial, consumer, enterprise, and market conditions differentiate the Chinese Mainland, Hong Kong SAR and Taiwan. Some of these “strong border” features may weaken or vanish, but there are many that become stronger over time and become associated closely with a special regional strength that creates competitive advantage and draws investment for the region.

Whether within single companies, company groups, or economies as a whole, sustained differentiation and specialisation create the opportunity for unique co-development. From a regulatory standpoint, differentiation is maintained through distinct systems of taxation, customs, judicial process, banking regulation, currencies, financial markets, and the like. From a market standpoint, differentiation is sustained by consumer taste, behavior, and capacity, standards of living, and scale.

Strong synergies and a unique range of opportunities for business cooperation and competition are generated by the different advantages of each region and each system. Regulatory and market differences result in different reactions to major global events, such as the global financial crisis, indicated in diverging GDP growth across Greater China. This is a source of strength for Greater China overall, as one region may be well-defended or find value creating opportunities in external events that create stress in another region of Greater China. While the sovereignty situation is somewhat unique in China, the economic arrangements among the Chinese Mainland, Hong Kong SAR and Taiwan can be usefully compared to other situations in the world.

Throughout the decades of reform, China has paid great attention to internal borders that delineate the regions over which the People’s Republic of China has sovereignty. Historically, these regions have developed under different governance with different economic models. Strategic management of the regulatory, commercial, and financial borders between the Chinese Mainland, Hong Kong SAR and Taiwan has supported a phased process of both integrating economic activity and sustaining the unique strengths of each region.

The balance between integration and harmonisation of the three economies on one hand, and differentiation and specialisation of each, on the other, is the key to mutual prosperity and strong development in the coming decade. As China works to sustain its dramatic recovery from the economic slowdown of 2008/2009, the interrelated growth of the Chinese Mainland, Hong Kong SAR and Taiwan will be ever more important.

At the core of regional specialisation that creates value are the powers of commercial and retail customers to buy and utilise services and the abilities of service providers, including banks, insurers, brokers, accountancies, consultancies, and other financial service providers, to anticipate, dimension, and meet customer demands. As we enter the new decade, there is a wealth of data and experience that can help government and business leaders understand the complex dynamics of demand and supply in Greater China and Asia.

In recent years, the economic and commercial activities linking the Greater China regions have increased significantly, through M&A, organic growth of finance companies, cross-border stock listings, and all forms of cross-border, travel, trade, and investment. In measures like financial service M&A, there was a slight slowdown in 2009, related to the global crisis, but the decade-long trend is strongly upward, and we expect that to continue. Similarly, Greater China has seen strong growth in trade with other countries in the region, especially ASEAN countries, and new trade agreements, currency projects, and investments are growing at a strong pace. Growth of China and Asia, hand in hand, was the major focus of Premier Wen Jiabao’s presentation at the 2009 Boao Forum for Asia.
At the same time as these developments continue to transform financial and commercial activity within Greater China and between Greater China and Asia, global changes in the wake of the crisis will impact the China region’s financial service industry. The shock of the crisis to financial services in the West has already brought about structural changes. An on-going process of regulatory refinement will reshape the reporting and regulatory environment globally in specific ways. Risk management is a highlighted challenge to major financial service providers, who are adjusting to new benchmarks of credit management and returns on investments. One important trend is that financial investors, such as PE and VC funds are rapidly increasing cross-border investment flows as well as their operating footprints. The China region’s financial services providers will be deeply influenced by these trends, in part because they are becoming larger, more multi-national, and more influential in global financial activities. There are specific operational developments that will be important for financial services providers in all parts of Greater China in the coming decade. Similarly, within China certain cities are emerging as important centers for different kinds of activities, hosting global equity investment funds, providing special financial services, or piloting new kinds of branching and alliances. Many such as Chongqing, Fuzhou, Hong Kong SAR, Shanghai, Shenzhen, Tianjin and Xiamen have had special importance throughout China’s reform.

The accompanying presentation provides preliminary findings of the research developed by Deloitte’s China Research and Insight Centre (CRIC). They are a roadmap for further exploration of these subjects, which we believe are important to understand for government policy makers and regulators, business leaders, financial investment, and researchers.

Following a practice of Seeking Truth in Facts (实事求是), we base our analysis on several kinds of data and reports relating regulatory and market trends, primarily in the three economies of Greater China. These include comparative studies of the currencies, capital markets (both indices and IPO results), macroeconomic information, trends, and achievements, and developments in cross-border equity investment and trade. These also include brief reviews of regulatory changes, both past and impending, cross-border agreements, market-based restructuring, consolidation, and cooperation based on M&A and branching activities.

They cover evolving changes in reporting and other standards essential to the smooth interoperation of the economies. Finally, we provide some comparative cases from other geographies, some outside of Asia, where regulation, tax policy, currency, and other “strong border” differentiators support successful and sustainable competitive positioning in the region. These include currency borders (Switzerland), tax borders (Gibraltar, Jersey, Guernsey Island), and special financial regulations (Luxembourg).

Our views on these issues are shaped by data we have collected from diverse sources, analysis of this data by the CRIC team and participating partners in the project, and outside experts who have shared their views with us. The report does not include specific suggestions for regulation or commerce, but we hope to provide a useful platform for further research and discussion of these issues crucial to the optimal development of Greater China and the Asian region.
The Deloitte China Research and Insight Centre ("CRIC") was established by Deloitte China in 2008 to provide our clients in China and around the world with information on developments in China which may be relevant to their businesses.

The CRIC publications range from in-depth reports examining critical issues and trends to executive briefings which update on new developments and their impact. CRIC also contributes to the development of Deloitte global research publications in collaboration with research centres around the Deloitte global organisation.

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