

## Study on the Development of the Intermediate Business of Commercial Banks in China

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Received 12 February 2015; accepted 2 April 2015  
Published online 26 June 2015

### Abstract

China's commercial banks have developed intermediate business for decades, but compared with western developed countries, they are still left far behind with many problems including limited types, small scale, low quality and lacking unified charging standards. The hidden causes behind these questions are the banks' lack of attention to the intermediate business, lack of versatile talents, lack of innovation and lack of sound legal system. In order to solve the dilemma, all of the parties need to coordinate, the banks should pay enough attention to the intermediary business, colleges and universities should cultivate more complex and practical talents, the society should vigorously encourage innovation, supervision departments should establish a sound legal system and charge management system.

**Key words:** Commercial bank; Intermediary business; Innovation

Zhang, Y., & Tan, F. F. (2015). Study on the Development of the Intermediate Business of Commercial Banks in China. *Canadian Social Science*, 11(6), 104-108. Available from: <http://www.cscanada.net/index.php/css/article/view/7100>  
DOI: <http://dx.doi.org/10.3968/7100>

### INTRODUCTION

In recent years, as the interest rate market continues to advance and "financial disintermediation" is becoming increasingly serious, the traditional business—deposits and loans business of commercial banks in China has

been seriously affected, and the banks can hardly obtain huge profits through loan spreads, so commercial banks need to upgrade their business, especially need to focus on the development of the intermediary business. The significance and value of this topic lies in: The healthy development of the intermediary business of commercial banks can help the banks successfully pass transition and realize healthy long-term development, besides it is also conducive to improving international competitiveness of commercial banks in China, to adapt to the increasingly fierce international competition.

In recent years, many scholars both at home and abroad have conducted many studies on the intermediate business of commercial banks. The foreign studies mainly focus on the productivity and risk management of the banks. Many foreign scholars believe that the intermediate business can improve the productivity of the banks. Rime and Stiroh (2003) found that the intermediate business can improve the banks' overall profit margins by studying the business performance of the Swiss banking industry of 1996 -1999. According to the study conducted by Claudia (2005) on the banking market of 1994-2000 in five European countries including Britain, Germany, France, Spain and Italy, the results also indicate the effects of the intermediary business on the productivity of the banks. All the studies of Stiroh (2008), Demirgiic-Kunt and Huizinga (2010), Altunbas, Manganel, and Marques-Ibanez (2011) have shown that expanding the intermediate business scale will increase the risk of banks, finding that the bank can obtain the benefits of risk diversification when the proportion of non-interest income is very low.

The domestic studies mainly pay more attention to looking for the source of problems from the current development of the middle business, and then putting forward constructive suggestions. Liu Jianguo, Yan Xiaodong and Liu Kuining (2011) found in the studies that in the development of the intermediate business of commercial banks in China is faced with limited business

types, weak innovation ability, imperfect supporting mechanism and other problems, and put forward countermeasures of accelerating product innovation, improving the organizational system and changing the traditional public idea. Wei Zige (2011), starting from the regulatory perspective, analyzed the current situation of and problems in the intermediate business supervision in China, aiming to realize the intermediate business development through innovative regulatory ideas. Xie Lushan (2012) analyzed the problems from China's commercial bank intermediate business pricing perspective and provided the corresponding pricing solutions.

## 1. CURRENT DEVELOPMENT SITUATION OF COMMERCIAL BANK MIDDLE BUSINESS IN CHINA

The intermediary business of commercial banks can be understood in a broad and a narrow sense. The intermediate business in a general sense refers to the non-interest income business that does not influence the on-balance sheet assets and liabilities of commercial banks. The intermediate business in a narrow sense refers to the business that constitutes probable capitals and probable debts. This paper is about the generalized intermediate business.

### 1.1 Types of the Intermediate Business

The business of commercial banks can be classified into 3 types of asset business, liability business and intermediate business according to the sources and uses of funds. The liability business of commercial banks forms the capital source of commercial banks. The fund source of commercial banks mainly contains deposits, loans and the banks' own capital. The asset business of commercial banks refers to the practice that the commercial banks use

the deposit funds to be engaged in various credit activities to obtain profits, mainly including two categories of loan business and investment business. The intermediary business of commercial banks is the business whose income is not included in the on-balance sheets of banks but can affect current profits and losses. In China, the People's Bank of China defined the intermediary business of domestic commercial banks into 9 types of payment settlement, bank card, agency, guarantee, commitment, transaction, fund custody, consultant and other types in the *Notice on the Relevant Issues on the Implementation of Provisional Regulations on Intermediary Business of Commercial Banks* (2002).

Looking through the financial reports of all the commercial banks, we can find they are all involved in the above nine types of intermediate business, but still mainly concentrating on the payment and settlement, bank card and consultant business developed on the basis of deposits and loans, with less involvement in credit commitment, guarantee, financial derivatives deals and other high-end business.

### 1.2 Scale of the Intermediate Business

The number of commercial banks dealing with intermediate business can be used to reflect the scale of the intermediate business, but given the difficulty of getting the statistical data, in this paper the proportion of non-interest income in the operating income is used to reflect the scale of the intermediate business. The commercial banks' operating income includes both interest income and non-interest income. The former is created by the deposit and loan business while the latter comes from the intermediate business. Five large state-owned joint-stock commercial banks and three medium or small-sized joint-stock banks are taken as examples in the following table to analyze the development scale of the intermediate business of commercial banks in China.

**Table 1**  
**Proportion of Non-Interest Income in the Operating Income**

Bank	2007	2008	2009	2010	2011	2012	2013	2014
ICBC	12.17%	15.08%	20.56%	20.24%	23.66%	22.18%	24.81%	25.10%
CBC	12.16%	15.92%	20.70%	22.25%	23.30%	23.34%	23.41%	23.33%
BOC	21.34%	28.63%	31.58%	29.93%	30.50%	29.81%	30.41%	29.63%
BOCOM	13.77%	14.38%	17.76%	18.46%	18.48%	18.47%	20.54%	24.03%
ABC	12.15%	8.21%	18.28%	16.62%	18.67%	18.98%	18.68%	17.46%
CMBC	17.23%	15.23%	21.54%	20.04%	20.64%	22.05%	25.41%	32.47%
CMSB	10.75%	13.24%	23.35%	16.24%	21.30%	25.17%	28.35%	31.99%
CIB	5.48%	11.86%	14.13%	12.48%	15.26%	17.61%	21.45%	23.49%

Note. Data sources: 2007-2014 annual financial reports of the banks (A shares).

As can be seen from the table above that the proportion of non-interest income of the eight commercial banks is

in a rising trend on the whole in nearly eight years, while that of the interest income is in a downward trend on the

whole. The non-interest income from the middle business accounts for 20%-30% and the interest income accounts for 70%-80%.

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## 2. PROBLEMS IN THE DEVELOPMENT OF THE INTERMEDIATE BUSINESS OF COMMERCIAL BANKS

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### 2.1. Limited Types

At present banks in Europe and the United States enjoy abundant source of income in the intermediate business, such as payment and settlement, bank cards, trust, sales of securities, investment banking etc.. The American banks are known as “financial department stores” due to their wide operating range, while China’s commercial banks can only be called “retail sections” (Tao Yana, 2012) compared with them. The current intermediary business of commercial banks in China is mainly around the traditional business and confined to payment and settlement, bank cards, collection and payment, foreign exchange of credit and so on, rarely engaged in some high-tech and high value-added business areas, such as investment and financing business, financial derivatives trading business, mergers and acquisitions business.

### 2.2 Small Scale

From the proportion of the banks’ non-interest income in the operating income, we can find the proportion of the no-interest income of commercial banks in China is increasing each year, but only at 20%-30%, meanwhile, although the interest income accounts for less year by year, the proportion is still as high as 70%-80%. This shows that the intermediate business of China’s commercial banks has developed in recent years, but the overall scale is still small with no scale effect. In addition, most products are only in some big cities and haven’t gone deep in small cities and towns, failing to form the scale effect across the country. To carry out the non-interest business needs investment of a large amount of fixed costs, which will increase the banks’ operating costs to a certain extent, only by expanding the scale of the intermediate business, can the unit costs be reduced, to realize economies of scale (De et al., 2001).

### 2.3 Low Quality

In recent years, Chinese commercial banks have carried out the intermediate business in a certain number, but the quality is not high, especially the dominant expression is the lack of innovation and serious product homogeneity.

The intermediate business of commercial banks in China has formed a system around the nine types, but it is still mainly around the traditional payment and settlement, agency and other labor-intensive products (Zhang, 2014), having no cross domain comprehensive high-end products. The banks expand the business every

year, but they closely focus on the traditional business with no big change. They fail to meet customer needs either in speed or, in quality, standing at a significant disadvantage in competing with foreign banks for high quality customers. By observing the intermediary business products on the market, we can also find the banks’ products are very similar in the aspects from the appearance to functions and returns, with no obvious difference, which leads to vicious competition between banks, even losing the power of innovation completely. The lack of innovation and serious homogeneity are serious problems existing in the development of the intermediate business of commercial banks.

### 2.4 Lacking Unified Charging Standards

On February 16, 2014, the CBRC and the NDRC jointly issued the *Interim Measures for the Management of the Service Prices of Commercial Banks*, stipulating the intermediate business charge subject to market regulation should be formulated and adjusted by the head office of each commercial bank. This gives each commercial bank strong pricing power, as for the simple bank card business, different banks provide an absolutely different charging standard, some receiving no charges while others receiving 10 to 20 Yuan. There is also some business that would charge but doesn’t to attract customers (Cao, 2007). The result is the formation of chaotic situation in charge of intermediary business.

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## 3. CAUSES OF PROBLEMS IN THE INTERMEDIATE BUSINESS OF COMMERCIAL BANKS

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### 3.1 Banks’ Lack of Attention

One of the causes of the afore-mentioned problems in the development of the intermediary business of commercial banks is that banks fail to pay enough attention to it. For a long time, commercial banks, affected by the traditional banking business philosophy, have put the development of the deposit business and loan business in the first place to gain profits depending on the interest margins. They have not developed the intermediate business only as a tool to expand the traditional business market instead of a pillar banking business. The banks are the main force to expand and market the intermediary business, but they lack attention to the intermediary business themselves.

### 3.2 Lack of Versatile Talents

The intermediate business integrates talents, technology, Internet, information and reputation as a whole as a typical knowledge intensive business (Jia, 2012), correspondingly, it requires the people engaged in the intermediary business should be highly qualified. The bank staffs involved in the intermediate business need to know the financial, legal, financial, tax and other

knowledge besides the knowledge of traditional business. Because of the late start of the corresponding marketing concept, network and information technology in China, such versatile talents are scarce relative in the country, which restricts the promotion and development of the intermediate business of commercial banks in China to a certain extent.

### **3.3 Lack of Innovation**

For the largely homogenous intermediate business products on the market, the deep-seated cause hidden behind is the lack of innovation. You can see it only from the establishment of the banks' internal departments. Most commercial banks in China have no intermediate business development departments, leaving the development departments included in their business sections (Yu, 2014). The commercial banks in western countries attach great importance to the development of intermediate business products with a lot of money invested in developing new products every year, so far, they have developed tens of thousands of mature intermediate business products. Besides, they also pay special attention to adjusting measures to local conditions and introduce differentiated products according to different customs and demand characteristics in different regions. Lacking innovation consciousness and following the crowd are particularly serious in the intermediary business of commercial banks in China.

### **3.4 Lack of Sound Legal System**

The healthy development of the intermediate business of commercial banks needs a sound legal system, but there are big problems in current laws and regulations of commercial bank intermediate business in China, on the one hand in general specification and implementation rules, on the other hand in the legal support for new products and new services. In 2001, the People's Bank of China promulgated the *Provisional Regulations on Intermediary Business of Commercial Banks* to guide the intermediary business of commercial banks. But the regulations only regulate the intermediate business types without providing targeted answers to the problems that may be encountered in practicing the intermediate business (Jia, 2012). This leads to the fact that the banks have considerable autonomy in practice and too much autonomy tends to result in unfair competition and other problems. So far, China has not made a law to protect the intellectual property of intermediate business products, thus the intermediate business products developed at the expenses of a lot of manpower, material and financial resources cannot get intellectual property and easily copied by others without much effort. So there will be no banks willing to invest a lot of costs in R&D of intermediate business products over time. Imperfect legal system cannot fully regulate the operation of the intermediate business.

## **4. COUNTERMEASURES TO SOLVE THE PROBLEMS IN THE INTERMEDIATE BUSINESS OF COMMERCIAL BANKS**

### **4.1 Banks Should Pay Enough Attention**

In promoting the healthy development of the intermediate business of commercial banks in China, the banks should play a crucial role of their own. First, the banks should pay enough attention to the intermediary business, no longer just taking the intermediate business as means to expand the deposit and loan business, but as the pillar banking business. In addition, corresponding intermediate business development departments should be set up, equipped with the appropriate professional personnel with a lot of money invested for product development, personnel training and equipment renewal.

### **4.2 Colleges and Universities Should Cultivate More Complex and Practical Talents**

The development of the intermediate business needs a large number of versatile talents, for they are the driving force of the development of the intermediate business of commercial banks. Colleges and universities should actively cooperate with commercial banks in this respect and cultivate more versatile talents. In the teaching process of colleges and universities, besides basic knowledge on commercial banks and the central bank, financial, legal, information technology and other relevant knowledge should be covered, by this way, the cultivated talents are all round skilled and can be competent for the intermediary business of commercial banks. In addition, attention should be paid to the combination of theory and practice, so the theory should be combined with the commercial bank business operation process in the teaching process. The qualified colleges and universities can also provide some simulation courses, really enabling students to put what they have learned into practical use. The versatile and practical talents cultivated by colleges and universities can eventually become a great impetus to the development of the intermediate business of commercial banks.

### **4.3 Society Should Vigorously Encourage Innovation**

As the main theme of the 21<sup>st</sup> century, innovation also has extraordinary significance in the intermediary business of commercial banks. However, innovative ideas and the atmosphere are not formed in a short duration of time, for it is a slow process and needs suitable soil. When China's economy is in the "new normal", the whole society should vigorously encourage innovation, driving the growth of the Chinese economy. Only under the conditions where the society encourages innovation, will the commercial banks pursue innovation in development of intermediate business products, presenting a superb collection of various intermediate

business products to get rid of the dilemma of product homogenization in the past.

#### 4. 4 To Establish a Sound Legal System and Charge Management System

A sound system of laws and regulations can regulate the healthy development of the intermediate business of commercial banks. Intermediate business development requires both legal constraints at macro level and detailed instructions with implementation rules operation guide at the micro level. In addition, corresponding laws should be made to protect intellectual property rights of intermediate business products from being violated. Although the People's Bank of China and the NDRC in 2014 jointly issued the *Interim Measures for the Management of the Service Prices of Commercial Banks*, it is still hard to standardize the intermediary business charges of commercial banks. Under the marketization of interest rate, commercial banks would waive the intermediate business fees to attract customers in order to seek survival. This is obviously not conducive to long-term development of the intermediate business. Then the banking industry associations can be made full use of to develop reasonable charging standards and create fair competitive environment. The establishment of a sound legal system and charge management system will play a positive role in promoting the long-term development of the intermediate business of commercial banks.

#### CONCLUSION

By deeply analyzing a series problems in the development of the intermediate business of commercial banks in China such as limited types, small scale, low

quality and lacking unified charging standards, this paper puts forward some suggestions that the banks should pay attention to the intermediary business, colleges and universities should cultivate more versatile and practical talents, the society should vigorously encourage innovation, supervision departments should establish a sound legal system and charge management system, to promote the healthy development of the intermediate business of commercial banks.

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