Analysis of the Core Competitiveness of Chinese Banks Based on Financial Statements

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Abstract. China adapts to market trends and improves its financial system, unified large-scale commercial banks, joint-equity commercial banks, agricultural banks, and other commercial banking systems to create a competitive market. Increasing competition in the banking industry has driven all commercial banks to focus on improving their key skills. This paper analyses Bank of China's fundamental skills through financial statements and makes development-related insights. Core competences help organizations maximise earnings and sustain a competitive advantage, according to this paper. The paper analyses Bank of China's background and external environment, then its balance sheet, income statement, and cash flow statement. Industrial and Commercial Bank of China, Agricultural Bank of China, and China Merchants Bank are used as comparative objects to analyse Bank of China's operation from multiple perspectives. The study says Chinese banks are extremely liquid but less profitable than competitors. Bank of China's strengths include its liability management and worldwide diversification, but it also has a poor resource allocation, a single capital structure, unstable operating cash flows, and considerable external impact.

Keywords: Bank of China; core competitiveness; financial statements.

1. Introduction

Since 1978 with China's reform and opening-up policy, the market economy has flourished. The active development of numerous financial mechanisms has enabled the banking industry to play an ever-increasing part in the national economy's growth. Simultaneously, China's financial sector has continued to open up to the rest of the world, as the number and diversity of China's financial institutions abroad have grown and foreign investment financial institutions have entered the Chinese market.

Bank of China is China's longest-running bank. This longevity has resulted in a solid business management model, strong resources, an accumulated and powerful customer base and an excellent brand image, forming the most international and diversified bank in China. However, in a highly competitive domestic and international market, Chinese banks still need to forge ahead and improve their core competencies in order to develop better.

Corporate core competencies were formally introduced by professors from the University of Michigan Business School C.K. Prahalad and London Business School G.Hamel in their paper The Core Competencies of the Corporation published in the Harvard Business Review in 1990 [1], where they argued that corporate core competencies are the combination of coordinated production skills and technology to deliver work organization and value.

This paper begins with a logical starting point for Bank of China's own strategy, taking into account the current domestic financial market environment and national policies, as well as Bank of China's balance sheet income statement cash flow statement for the past three years, and considers Bank of China's operating conditions, debt capacity and future business target positioning from multiple perspectives. The core competencies of Bank of China's peers are interpreted comprehensively from multiple perspectives, including culture shaping, operational business management, risk and cost control and technological advancement and innovation.

Equivalent large domestic state-owned commercial banks are selected as compactors to analyse Bank of China with the current share in the Chinese financial market, the strength of their competitiveness and the strength. Through the analysis of various aspects of the financial statements of Chinese banks, the current operational strengths and problems of Chinese banks are analyzed, and relevant countermeasures are proposed to address the problems in enhancing the core competitiveness of Chinese banks.

2. Bank of China Strategy

The Bank of China has existed for about one hundred years. With the natural benefit of having a lengthy history of foreign exchange operations, it has become a vital avenue for the country to employ foreign cash. On this basis, Bank of China has diversified internationally to provide comprehensive financial services to its global customers, with its corporate finance business being its primary source of business profits, providing personalised and innovative financial services to its customers, implementing a development strategy focused on serving important significant and high-quality corporate customers, and focusing on preserving long-term relationships with such customers.

Meng Ruiyu (2012) mentioned that if Chinese banks want to maintain their edge in an increasingly competitive industry, they need to retain their traditional financial business and vigorously develop first-mover business models to open up new markets at a lower cost [2]. In addition, the internationalisation of their operations is exposing Chinese banks to a more complex and volatile external financial environment, which places higher demands on their risk management.

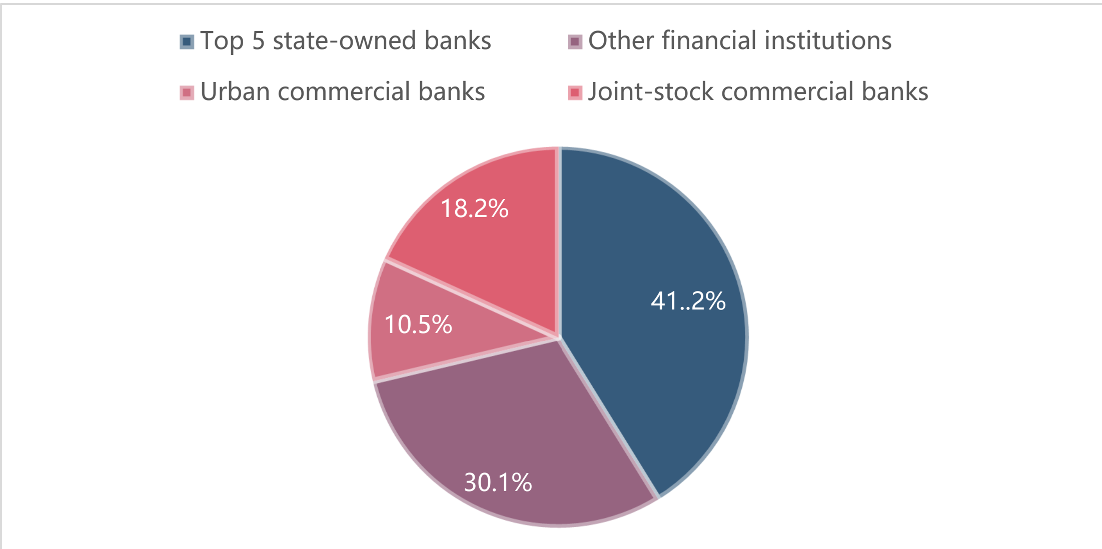

Fig.1 The distribution of financial assets in China
Data source: China Banking Regulatory Commission website

In figure 1 demonstrates that the five largest state-owned banks in China hold the largest proportion of financial assets in the financial sector, although the market economy is developing and joint-stock commercial banks are expanding rapidly. Currently, these five banks have a substantial competitive edge in China's commercial banking sector. ICBC, Agricultural Bank of China, and China Merchants Bank were selected as compactors for the subsequent financial examination, along with Bank of China.

3. Financial Analysis

By evaluating Bank of China's financial statements, it can comprehend its operating performance and cash flow and compare its strengths and weaknesses to those of Industrial and Commercial Bank of China, Agricultural Bank of China, and China Merchants Bank. ICBC and Agricultural Bank of China are state-controlled banks like Bank of China, while China Merchants Bank is a joint-stock commercial bank.

3.1 Balance Sheet Analysis

A balance sheet depicts the composition of an organization's assets, liabilities, and owners' equity at a specific date or time. The statement's principal objective is to present the enterprise's financial position, including its financial structure and financial hazards. The balance sheet is used to analyse the trends in the financial situation, asset and liability structure, and competitive advantages and drawbacks of Chinese banks.

Table 1. Analysis of balance sheet trends of Chinese banks

Item	2021	2020	2019
Customer Loans	57.34%	56.7%	55.97%
Investment	23.07%	22.91%	24.22%
Total Assets	100%	100%	1005
Customer Deposits	74.44%	75.90%	76.07%
Total liabilities	100%	100%	100%

Data source: 2019-2021 Bank of China Annual Report

In table 1 that show that over 50% of the assets of Chinese banks over the year are customer loans, over 20% are investments, and over 70% of the liabilities are customer deposits, thus establishing a careful analysis of customer deposits, investments, total assets, and customer deposits.

3.1.1 Customer lending analysis

2019 to 2021 Bank of China customer loans grew at an overall even pace, with a normal range of loans between 8% and 11% in a normal year. Complying with the national policy to support the development of the real economy and fulfilling its role as a responsible bearer of the travel country has led to a better growth in total loans.

3.1.2 Investment analysis

Bank of China's investments increased by only 1.40% in 2020, but by 10.26% in 2021. in late 2019, due to the impact of the global epidemic, Bank of China adjusted its investments, taking into account the risks and returns, by reducing the total amount of foreign currency investments and increasing its holdings in RMB. However, by 2021, China's domestic epidemic gradually stabilized and the national government enacted a proactive fiscal strategy and a conservative monetary policy, directing financial institutions to boost their support for the real economy, particularly in terms of technical innovation and environmentally sustainable development, expanding domestic demand strategies and enhancing productivity within development. Bank of China's investments continued to recover, and in view of the gradual stabilization of the domestic epidemic, the Bank of China closely tracked the financial dynamics of the market and increased its holdings of foreign currency investments. Bank of China's investment growth was slower than loan growth reflecting a focus on allocating capital to the lending business and a more conservative approach to investment business development.

3.1.3 Total assets analysis

This shows that the size of Bank of China's assets grows year on year from 2019 to 2021 by 7.17% in 2020, 9.51% in 2021 respectively. The overall trend in asset size growth is similar to the trend in customer loan movements, which is due to customer loans being a major component of assets.

3.1.4 Analysis of customer deposits

Customer deposits of Chinese banks show an upward trend from 2019 to 2021, increasing by 6.71% in 2020 and 7.49% in 2021, accelerating product and service innovation, which is conducive to improving financial services, growing and strengthening customer financial assets and enhancing the maintenance of customer relationships.

Overall the trend of changes in Bank of China's assets and liabilities, mainly by the trend of changes in customer loans and customer deposits, reflects the strategic positioning of Bank of China as a commercial bank at its core. T. Liu et al. (2011) advocated continue strengthening of liabilities, quality management related indicators to meet internal and external management, requires customer loans to increase year on year [3], however, loans increase faster than deposits increase the cost of liabilities of Chinese banks increase liquidity risk, Chinese banks should strengthen the impact of customer deposits to obtain a more stable income growth. In addition, Chinese banks are relatively cautious in terms of investment development is not as fast as the development of lending business.

Table 2. 2021 Relative ratios of assets, liabilities and shareholders equity by Bank

Item	Bank of China	ICBC	Agricultural Bank of China	China Merchants Bank
Total Assets	100%	132%	109%	35%
Total liabilities	100%	131%	109%	34%
Total shareholders equity	100%	139%	103%	37%

Data source: 2019-2021 Bank of China Annual Report

In table 2 indicating that the asset size of Bank of China ranks third among these commercial banks, industrial and Commercial Bank of China has the largest assets among state-owned commercial banks, whereas Bank of China and Agricultural Bank have comparable asset sizes, and that the investment size of China Merchants Bank is significantly less than the previous three state-owned commercial banks. As assets are the primary source of bank profitability, the larger asset size provides the material basis. Moreover, the debt-to-equity ratios of Bank of China and Agricultural Bank of China are comparable. China's commercial banks have a debt-to-equity ratio that is still relatively high. Increasing the shareholder equity ratio is favourable to enhancing bank profitability and lowering financing risk.

Compared to other banks, Chinese banks focus more on customer loans and invest a lower proportion of their assets than other banks in terms of resource allocation. Chinese banks should rationalize their resource allocation structure, maintain an appropriate amount of investments, Xiangyang. D (2014) indicated that achieve a better balance between liquidity and profitability while pursuing capital safety, and increase the profitability of their assets [4].

3.2 Income Statement Analysis

The income statement is a financial statement that shows the outcomes of an enterprise's activities for a specific accounting period and is a calculation of the enterprise's profits and losses for the period. Through the income statement, this module compares the trends in the earnings of the Bank of China and other commercial banks.

Table 3. Bank of China income statement trend analysis(Unit: RMB million)

Item	2021	2020	2019
Net interest income	425,142	415,918	390,050
Net non-interest income	180,417	149,613	159,132
Operating expenses	(329,428)	(320,407)	(299,645)
Net profit	227,339	205,096	201,891

Data source: 2019-2021 Bank of China Annual Report

From table 3, commercial banks are primarily engaged in the deposit and lending business, in addition to other activities, which equate to net interest income and non-interest revenue on the income statement. Following is a trend study of net interest income, net non-interest revenue, operating expenses, and net income.

First net interest income, overall growth trend of net interest income of Chinese banks from 2019 to 2021. The decline in asset yields due to declining yields on RMB loans within China and factors influenced by the expected Fed interest rate cut resulted in insignificant growth. In such a volatile and complex situation, Chinese banks should continue to optimise their asset and liability structure to control deposit costs and increase medium to long-term loan placement.

Secondly net non-interest income, which declined by 5.98% in 2020 compared to 2019. Affected by the full outbreak of the epidemic, the production capital market in mainland China was hampered and residents' willingness to invest was reduced, and Chinese banks did not achieve satisfactory results in intermediate business. By 2021, the domestic epidemic is basically under control, the market gradually recovers and non-interest income grows significantly.

The third operating expenditure analysis, Bank of China operating expenditure range is 6.93% and 2.82% respectively. The increase in operating expenses exceeded the increase in operating income. It was used to increase investment in technology and innovation, and to increase the training of talents as well as market expansion and resources for relevant backward regions, all of which are advantageous to Bank of China's long-term development. As Bank of China holds a large amount of foreign currency assets, its earnings are significantly affected by foreign economic conditions. Ma J.T et al. (2009) showed it need to continuously improve the risk management system and maintain adequate risk resilience [5].

The fourth net profit analysis shows that the net profit margin rises to 10.85% in 2021, except for 2020 when the net profit growth margin is only 1.59%. The impact of the epidemic and the significant decline in interest income due to the global economic downturn has increased impairment losses on foreign currency assets. Reflecting the overall stability of Bank of China's earnings under normal conditions, but the level of profitability will also be significantly affected by the impact of the external environment, and should optimise the allocation of production structure and co-ordinate epidemic prevention and control with operational management.

Table 4. 2021 Relative proportion of operating results by Bank

Item	Bank of China	ICBC	Agricultural Bank of China	China Merchants Bank
Operating income	100%	156%	119%	55%
Operating profit	100%	153%	107%	54%
Net profit	100%	154%	106%	53%

Data source: 2019-2021 Bank of China Annual Report

In table 4 proving that the operating performance of state-owned commercial banks is superior compared to China Merchants Bank in proportion to their respective asset sizes. The rising asset size of state-owned banks provides them with a robust stream of revenue.

In the table, the relative age of the operating profit of each bank and the relative proportion of net profit do not differ much, and the analysis here focuses on net profit. Industrial and Commercial Bank of China and Agricultural Bank of China had net incomes that are 1.54 and 1.06 times more than Bank of China, respectively. Because the Bank of China to strengthen the investment in science and technology innovation, the key product areas of the region's resources to support the strength of activities such as increased to the business operating management expenses brought me to the Bank of China in the short term profitability decline, reminded the Bank of China to pay attention to the business process of cost control.

3.3 Cash Flow Statement Analysis

The cash flow statement is a summary of the changes in cash and bank deposits, which clearly reflects the cash inflows and outflows from the operating activities of commercial banks, such as investments and financing, and reveals the liquidity and profitability of commercial banks' assets.

Cash flow from operating activities is the foundation for commercial banks to maintain normal operations, and by analyzing this table can see whether the operating activities of Chinese banks are functioning normally.

Table 5. Comparison of net cash flows from operating activities by Bank(Unit: RMB million)

Item	2021	2020	2019
Bank of China	843,258	73,028	(484,266)
ICBC	360,882	1557,616	694,521
Agricultural Bank of China	239,615	(60,936)	352,571
China Merchants Bank	182,048	421,328	4,432

Data source: 2019-2021 Bank of China Annual Report

In the majority of years, the majority of banks had positive net cash flows from operating activities, but in 2019, Bank of China experienced negative net cash flows from operating operations, but had the largest net cash flows of these banks in 2021 in table 5. As Bank of China's net cash flows from recent activities fluctuate significantly, a further analysis of the three-year cumulative net funds generated by operating operations is provided below in order to more accurately assess the impact of Bank of China's operational activities cash flows on profitability.

Table 6. Comparison of cumulative net cash flow from operating activities to cumulative net profit by bank(Unit: RMB million)

Bank of China					
Item	**2021**	**2020**	**2019**	Cumulative amount	Net profit to cash ratio
Net cash flow from operating activities	843,258	73,028	(484,266)	432,020	0.68
Net profit	227,339	205,096	201,891	634,326	
ICBC					
Item	**2021**	**2020**	**2019**	Cumulative amount	Net profit to cash ratio
Net cash flow from operating activities	360,882	1557,616	694,521	2,613,019	2.67
Net profit	350,216	315,906	312,224	978,346	
Agricultural Bank of China					
Item	**2021**	**2020**	**2019**	Cumulative amount	Net profit to cash ratio
Net cash flow from operating activities	239,615	(60,936)	352,571	531,250	0.79
Net profit	241,936	215,925	212,098	669,959	
China Merchants Bank					
Item	**2021**	**2020**	**2019**	Cumulative amount	Net profit to cash ratio
Net cash flow from operating activities	182,048	421,328	4,432	607,808	1.96
Net profit	120,834	97,342	92,178	310,354	

Data source: 2019-2021 Bank of China Annual Report

Bank of China's net cash flow from operating activities was positive on a three-year cumulative basis and was 0.68 times the three-year cumulative net profit from table 6. Overall, Bank of China's cash flow from profit-making activities ensures profitability to a certain extent, but a comparison with individual banks shows that Bank of China's cumulative net cash flow from operating activities is less than one-third that of ICBC and is significantly lower than the other three commercial banks for the combined three years, with Bank of China's lower realisation of profitability from operating activities not being of high quality.

The combined cash flow data of the four banks shows that Bank of China had a negative net cash flow in 2019, while all other banks maintained a relatively stable positive value during the year. This indicates that the domestic macro-financial environment was relatively normal at the time and that Bank of China's negative net cash flow from operating activities was mainly a result of its own operating conditions. The 2019 cash inflows from operating activities were clearly seen to be smaller than cash outflows. However, customer loan growth remained above 50% in 2019 and the issuance of loans allowed for significant cash outflows, resulting in the main reason for negative cash flow from operating operations for 2019.

A. Ferrari et al. (2021) suggested cash outflows from loan origination were not coordinated with cash inflows from deposit taking to ensure normal financial flows generated by operating activities and to maintain the relative stability of operating activities [6].

3.4 Capital Management and Liquidity Risk Management

A review of the financial statements shows the financial and operational situation of Chinese banks and their development trends, followed by a further analysis of the core competencies of Chinese banks in the context of a comprehensive consideration of the safety, liquidity and profitability of commercial banks.

Table 7. Comparison of security by Bank in 2021

Item	Capital Adequacy Ratio	Core Tier 1 Capital Adequacy Ratio	Non-Performing Loan Ratio
Bank of China	16.53%	11.28%	1.33%
ICBC	18.02%	13.31%	1.42%
Agricultural Bank of China	17.13%	11.44%	1.43%
China Merchants Bank	17.48%	12.66%	0.91%

Data source: 2019-2021 Bank of China Annual Report

For table 7, Bank of China's capital adequacy ratio and core Tier 1 capital adequacy ratio rank relatively low among the four banks, and the non-performing loan ratio ranks second among these banks in order of low to high indicator values. Overall, the safety of Bank of China is less prominent among these four banks capital, capital adequacy ratio and core tier 1 capital adequacy ratio is a measure of a bank's ability to face risk losses from the perspective of capital management, Bank of China ranks low in these two ratios, indicating that the level of capital management of Bank of China needs to be improved. 2021, Bank of China redeemed RMB 28 billion of domestic preferred shares, which to a certain extent reduces the cost of capital, reflecting the importance of strengthening the management of capital instruments in stock. However, there is still a need to optimise the capital management governance structure and revise the capital management regulations.

The non-performing loan ratio reflects the bank's asset quality position, and Bank of China is relatively high in this ranking, indicating a higher level of risk management and operational safety as Bank of China's loan quality has a greater advantage compared to its industry competitors. The unstable cash flow of Bank of China has a greater impact on its ability to make payments and also poses a threat to the security of its operations.

Notable is the fact that the non-performing credit ratios of the three state-owned financial institutions exceed those of China Merchants Bank, showing that the asset quality of state-owned banking industry relative to joint-stock commercial banks is inadequate, necessitating the strengthening of credit management and the enhancement of the capacity to resist credit risks.

3.5 Liquidity Ratio

Table 8. Liquidity Ratio from 2019 to 2021

Item	2021	2020	2019
Bank of China	49.6%	54.5%	54.6%
ICBC	41.5%	43.2%	55.77%
Agricultural Bank of China	62.01%	59.15%	57.74%
China Merchants Bank	48.33%	42.06%	51.18%

Data source: 2019-2021 Bank of China Annual Report

The liquidity ratio is used by commercial banks to measure their overall liquidity. Bank of China's liquidity ratio is second only to Agricultural Bank among the four largest banks in terms of overall liquidity, meaning that Bank of China's assets are more liquid and its capacity to service short-term debt is greater from table 8. If necessary, the bank can meet its future liquidity needs by pledging assets.

3.6 Summary of the Financial Analysis

Overall, Bank of China has strong liability management capabilities on the one hand. Customer lending is significantly higher than other banks, and it has more initiative under liability management. The ability to diversify internationally stands out constantly and increases innovation in new technology products. At the same time, capital liquidity is better and the non-performing loan ratio is at a lower level in the country. On the other hand, there is an uneven distribution of asset allocation, with a lower investment share and a lower growth rate of customer deposits than customer loans, creating a potential liquidity risk for Bank of China. The investment ratio of Bank of China is lower than that of other banks, and it cannot fully play its role in obtaining returns from investments, diversifying risks and maintaining the liquidity of capital assets. At the same time, the profitability of Chinese banks is weak. Bank of China's ability to generate income cannot match operating costs similarly, the People's Bank of China per capita profit is not high, the Bank of China cash flow is unstable, while the stability of the impact of the operation fluctuates widely, or even a large negative value. In addition by external factors, he Bank of China as China as China's highest level of internationalization of commercial banks hold a large number of foreign currency assets, operating foreign currency business is also more, less the international financial environment exchange rate fluctuations have a greater impact on the Bank of China's risk management has put forward higher requirements. The higher the liquidity, the better the safety and the lower the risk, the lower the profitability level of the bank will become. Improve operational management to ensure safety and liquidity on the premise of improving profitability.

4. Recommendations

4.1 Optimise Asset Allocation

Increase the share of investments in total assets. Obtain returns by allocating investments appropriately e.g. by selling portfolio investments to obtain capital gains above import prices. Manage the liquidity of assets by buying or selling medium and long-term bond investments, which are more conducive to the application of capital. Marta (2018) revealed enhance the profitability of assets, but in the process need to balance risk and return, especially when the international financial situation is unstable, and strengthen China's domestic investments while reducing foreign currency investments [7].

4.2 Improving Financial Innovation Capabilities

The financial products and services provided by various types of commercial banks are similar to a certain extent, Chengming Li et al. (2022) expressed Chinese banks need to improve this creative ability in order to remain competitive in the fierce market competition in the Internet information age modern technology should be widely used to improve the promotion and application of new technology to financial products and services design more reasonable and high quality financial products, financial derivative products and other new financial Break through the traditional counter service model, develop diversified and networked all-round service forms, and improve the convenience and comfort of services [8].

4.3 Optimizing Capital Structure

Although the proportion of shareholders' ownership in the capital structure has expanded dramatically, debt continues to represent a substantial element of the capital structure. Habib H.k (2022) illustrated the reliance on deposits as a source of funding reduces the efficiency of banks and increases their financing risks [9]. With the financial market improving and stocks and funds and bonds providing diversified options for Chinese residents to manage their finances, Chinese banks need to transfer the potential risks posed by deposits to continuously optimise, improve their capital structure, increase equity financing and broaden financing channels to promote a more stable development base for banks.

4.4 Strengthening Cash Flow Management

The net cash flow from operating activities of Chinese banks is very unstable and even has a large negative value. It is necessary to pay attention to the management of cash flow, improve the quality of earnings, ensure the stability of operations, consider forecasts in many aspects, budget analysis, cash flow management, co-ordinate the bank's operating activities investment activities and financing activities, and have clear management for the personnel responsible for all aspects of cash flow management A clear management of the personnel responsible for all aspects of cash flow management, with clear constraints and a system of incentives and penalties to ensure the steady and normal operation of cash flow management.

5. Conclusion

In this paper, the background and strategic positioning of Bank of China's operations and the external environment are analysed, and the product statements of Bank of China are analysed. The analysis is followed by asset management and liquidity risk management, as well as human resource management.

The competitive advantages of the Chinese banks that emerged from the analysis were their strongest liability management capabilities, their internationalisation and diversification capabilities, and the liquidity of their assets. The problems are unreasonable asset allocation, capital structure that is overly dependent on customer deposits, weak profitability, significant cash flow fluctuations that affect operational stability, and exposure to external influences in a complex and changing international financial environment.

In response to the above problems, this paper proposes four countermeasures, suggesting optimizing asset allocation and improving the ability of assets to generate income, and secondly, improving financial innovation capabilities and strengthening awareness of product and service innovation. Third, optimise the capital structure to increase the proportion of shareholders' equity is, strengthen cash flow management, improve the quality of earnings and stability of operations.

At present, domestic and foreign research on the core competitiveness of trade commercial banks is not sufficient has not yet formed a systematic theoretical system. In this paper have not fully drawn on the development experience of foreign banks, nor have chosen foreign banks as a comparative object of comparison The scope of the evaluation is relatively narrow for the analysis of financial statements, the depth as well as the research methodology, needs to be further improved.

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