

ANALYSIS ON STRATEGIC CHOICE OF CHINA'S SMALL AND MEDIUM-SIZED TRUST COMPANY'S DURING GLOBAL FINANCIAL CRISIS

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Abstract Under the background of the Global Financial crisis, Chinese trust industry confronted not only the chances that brought by new regulation and the state investment plan, but also encountered the recession and the increasingly fierce competition. Meanwhile, numerous China's small and medium-sized trust companies (SMT) are facing more adverse competition shortage of core competence against large-scale trust companies that are in the Market-led occupation. As the Matthew Effect in the trusts industry evolving, how do the SMTs Grasp the opportunities offered by the new situation is a problem worth considering. This paper's analysis is based on the status quo of trust industry, aiming to reset the strategic positioning of SMTs and describes three strategies ways for SMT to regain the initiative in fierce competition during the financial crisis.

Key words Financial crisis; SMT; New regulation of trust; Strategic choice

1 Introduction

1.1 The concept of SMT

SMT in This paper mainly refers to those trusts that possessed total assets less than 30 billion and did not enter the top 10 of the financial management capability ranking report of trust in 6 consecutive reporting periods. According to statistics, there are 50 trust companies in China and 34 of them are SMT. These SMTs are in relatively weak position when they encountered those the industry leaders (the other 14) in the direct competition. With the industry leaders' development of non-local business and the expectation of regulation approval about setting up non-local branch of trust, the SMTs are being marginalized or even washed out in the trust business. Thus, SMT must make adjustments in the strategic or even re-planning to break the current difficulties faced by.

1.2 The industry environment and the status quo of China's SMTs

Currently in China, there are big gaps between SMTs and those trust industry leaders in the market share, profitability and earnings means.

1.2.1 Polarization status of the trust industry

The overall number of China SMTs is Majority in trust industry, but all together they possess relatively low market share. Statistical data show that the trust income of Those 16 industry leaders is about 56% of the industry-wide total income in 2005, by the end of 2007 this figure had been as high as more than 75%, their trust assets are also rise from about 50% of industry-wide assets in 2005 to 69% at the end of 2008. As the degree of concentration of fund continues to rise, a more prominent polarization situation would be Inevitable.

On the contrary, although SMTs is 68% of the total number of China trust companies, their trust income and trust assets are only 23% and 31% about of industry-wide.

1.2.2 The low profitability of the main business

According to the Statistics of 2008 Annual Report, the average trust return of SMTs, the main business profitability indicators of trust funds, fall below the industry average of 1.06%. There are 4 trust have over 2% of trust return in the whole industry, only 1 from SMTs. However, there are 13 trust have less than 2% of trust return, and they are all SMTs.

1.2.3 Lack of Profitable means

Compare to those leaders in trust industry, the total profit of trust programs of SMTs are less than 25% of the whole industry. Many SMTs lack of ability of product development, resulting in their very low level amount of new trust product. And there are some trusts that locate in remote area can hardly profit from the high value-added creative products because their small scale couldn't even reach the qualification to sell these kind of product.

1.2.4 Looking forward to turnover the situation

After the chaotic period of the trust industry at the start of the 21st century, a few large-scale well-functioning trusts have become the industrial leader in recent years. As the competition becomes more exacerbated, the Matthew Effect is slowly formed in this industry. The next decade is a critical period for China's trust industry, as it grows and becomes stable after this 10-year period, its structure would be set. For the SMTs, if the Matthew Effect is formed in the trust industry, they would be marginalized or even washed out.

On the other hand, in the background of the spread of the global financial crisis and China's economic recovery, there are still many opportunities for SMTs to regain the initiative in competitions. How to enhance the core competence to seize these opportunities and to adjust strategy to turn over the situation is a common problem that many SMTs are facing nowadays.

1.3 The opportunity and challenge that brought by the financial crisis

By the international economic crisis and many other adverse effects of macroeconomic factors, the trust industry suffered a major setback last year. According to the financial statistics of the 2008 annual report, the main financial indicators of the trust industry declined at the same time, and for the first time in five years, the rate of increase was lower than the previous year. To make matters worse, the profit indicators sharply dropped by more than 30%. For SMTs, surviving and developing under the economic recession mostly depend on the ability of seizing the opportunity and going through the challenges. In the current situation, SMTs will face opportunities and challenges in the following.

1.3.1 Opportunity in the financial crisis

Firstly, as a result of the shocks brought by the financial crisis, the Chinese government introduced a 4000 billion investment plan at the beginning of this year. With the gradual implementation of this plan, at all levels of governments and all major industries are in urgent need of financing, asset management and consulting services. For the SMTs, these are not only opportunities for profit growth but also a great chance to enhance brand and the opportunity for attention.

Secondly, large-scale international or local financial institutions are actively looking for opportunities of growth in the global and domestic financial markets because of the impact of the financial crisis. More than a dozen of China's trust companies with mergers have proved that the trust market in China is being focused on. In this case, China's SMTs naturally seem attractive to these large-scale financial institutions because of their mixed operational business mode and many new businesses are allowed to operate by the new regulation, and most importantly, their own capital has a relatively small scale. As long as SMTs' conditions permitted, carrying out integration with large-scale financial institutions will be able to do better synergy in order to gain market share advantage.

1.3.2 Challenges in the financial crisis

However, in the financial crisis, the challenges that SMTs face can not be ignored. As the stock market downturn disastrously last year, leading to investment income dropping sharply for most trusts that are heavy equity holders of securities. This is the main reason why the trust industry suffered a profit decline in 2008. For the SMTs, whose strength is relatively weak, this kind of setback is hardly affordable. How to adjust the strategic positioning, and put more resources into enhancing the core competence, in order to fundamentally improve the profitability has become the most important issues of SMTs.

Furthermore, the financial crisis brought various types of risks to the trust industry, including credit risk, market risk, liquidity risk and operational risk. These will constitute threats to varying degrees for SMTs. Therefore, comprehensive risk management capability is imperative to improve SMTs.

1.4 The relationship of financial crisis and new regulation of trust

Under the impact of macroeconomics, although happening before the financial crisis, the new regulation of trust which was introduced in 2007 would still affect the strategy choice of SMTs.

Due to the new regulation, the trust industry is regulated in a more complete frame of law. In the long term, the new regulation has played a great role in promoting the industry to avoid unnecessary risks and stable development, thus, to a certain extent, enhancing the trust industry in resisting the financial crisis.

At the same time, new rules, in addition to regulating the operation of the industry, also put higher requirements (registered capital, return, etc.) for trust companies to obtain the new quality license which would be a key to operate high value-added businesses (PE, REITs, etc.). Compared to those industrial leaders, SMTs would have to try a lot harder to get the new quality license, especially under the effect of negative factors which were brought by the financial crisis.

Therefore, as a superimposed factor which mixedly impacts the trust industry with the financial crisis, the new regulation of trust will still be a critical environmental factor for SMTs.

2 The Impact of the New Regulation on SMTs' Strategic Choice

In January 2007, the CBRC issued two consecutive regulations. These two regulations open up a vast space for the trust industry to launch a new business, but also raise the threshold to enter or remain in the industry. Those who do not meet the requirements to have the new business license, if still can not after three-year transitional period, will be ordered to restructure or exit the market. Moreover, the REITs, QDII, PE, corporate pension, insurance trust funds and many other innovative products and businesses could only be applied by trust companies after they have the new business license.

As the immediate priority strategic objective, SMTs must therefore take the initiative to improve their qualifications so as to strive for new business license, otherwise further the strategic choice of the following would be out of the question, and the Trust itself is likely to be eliminated.

3 The Strategic Choice and Approach for SMTs to Confront the Financial Crisis

3.1 From financing platform to the financial service provider

Because of the low development of trust industry and lack of a comprehensive Corresponding legal regulation, SMTs were mostly doing loan business¹, the lowest rate of return and ability requirement, in the past. In other word, they were just being financing platform in the whole financial market. Therefore, Most of SMTs had little intend to develop their financial management capacity, product development capacity and investment management capacity, and all these are core competences. the directly result in the bottom of the value chain of the Bank-trust co-operation business as well as PE business co-operating with investment companies.

Table 1 General Situation of Each Businesses of Trust Industry

Type	Return level	Risk level	Competence requirement	Market trends
loan	low	medium	low	instable
Bank-trust co-operation	low	low	low	Sustainable
PE (co-operation with investment companies)	low	medium	low	instable
PE (Independent development)	high	medium	high	Increased stability
CTIP ²	medium	medium	medium	Increased stability
REITs	high	high	high	Increased stability
Enterprise Annuity	medium	medium	high	Increased stability
Investment of insurance funds	medium	medium	high	Increased stability

At present, many of SMTs still struggle in the "financing platform" position, business mainly concentrated in the loan business, Bank-trust co-operation business and PE business co-operating with investment companies. As we show from Table-1, these businesses require a low-capacity, and have low level of return as well as relatively narrow market space. Therefore, in order to extend their operational scope to those high value-added businesses to satisfy their urgent need for stable development, and to have an orientation to enhance their core competence, changing the strategic positioning to the financial service providers is imperative choices for SMTs.

3.2 Strategy approach one: From specialization to diversification

In China's financial sector, the trust industry has the widest range of business, across three markets: the capital, monetary and industrial. Naturally, SMTs not only have to face leading competitors in the trust industry, but also have to face banking, insurance, securities companies and fund companies, as a result of wide range of business.

But subject to the lack of capital strength and human source, SMTs have limited product design capability, marketing services capability, asset management capability and brand effect compared to banks, insurance companies and other large financial institutions. Therefore, today SMTs do not have any competitive advantages in every field of businesses.

¹ Most of SMTs' loans operate as equity investments with an additional commitment to repurchase

² Collection Trust and Investment Plan

Thus, some SMTs attempted to discard the approach of diversified product lines, and concentrated on product development capabilities in order to from specialize advantages. But it is difficult to succeed. The reason is that China's financial market, are not functional and efficient enough to support the specialization of trust company development.

From the Anglo-American trust industry experience, diverse product line is only and best approach for the trust to become a financial provider. Therefore, SMTs must adhere to the diversified product line approach to exert the unique strengths of the trust in order to be in a better position in the whole financial sector which inherently separate operation in different sub-sector. Only the unique strengths of the trust, including isolation, universal, risk limitation and flexibility, could ensure the trust company could fully meet the great demand for asset management in financial markets.

Secondly, after the introduction of new regulation of trust in 2007, Chinese financial regulatory authorities gradually aware of repressive regulation to the trust industry in the past will result in imbalance in development the financial system, and begin to adjust the regulatory principles to an appropriate degree. Meanwhile the Chinese financial regulatory authorities begin to open PE, QDII, enterprise annuities, insurance funds investment and, more recently, REITs and other new business area to the trust industry to stimulate the further development of the trust industry.

Thirdly, with the multi-level capital market, in particular the introduction of the GEM as well as the development of property rights trading market, to carry out PE business will have a better exit channels and the external environment. PE business is an important platform of multiple product lines, so, trust companies will directly benefit from the more comprehensive and better structure of capital markets.

Therefore, the improvement of the legal environment and the capital market structure is an opportunity for SMTs to exert inherent unique strengths of trust in the asset management industry³. Although, in fact, the resources deployment of SMTs may currently not available to develop each of the products in its business range, but from the point of view of long-term strategy, continuously enhance the core competence to meet the needs of the diversified product line, the ultimate business mode for SMTs or trust industry as a whole, is an inevitable choice.

3.3 Strategy approach two: Offering financial service to satisfy the governmental anti-crisis investment plan

As many experts said, the activation 4 trillion government investment plan hold even more opportunity for the trust industry than the sustained uprising of stock market over the last decade, which provoke the rise of several trust companies.

Given the current economic situation, SMTs, especially those from the midland, should satisfy the demand of the Government of each level and co-operate with them in infrastructure program to seize this opportunity of profit increase. On the other hand, according to the incomplete statistics of Galaxy Securities company, after the introduction of the governmental anti-crisis investment plan which is aim to provoke the domestic demand in the long run, local governments have also launched a local investment plans, total investment has already been as high as 18 trillion yuan. The local governments with such a huge investment demand are looking for other financing channels except the bank credit. SMTs have very good chance to satisfy these demands.

With the implement of the government investment plan, more opportunities are emerging; SMTs should exert their inherent unique strengths in order to obtain financing related projects. It is a worth-considering short-term approach that brought by financial crisis.

3.4 Strategy approach three: Capital Synergy

Integration with large financial institutions will be, in addition to relying on its own core competence brought about by the accumulation and growth, is another worth considering medium and long-term strategy approach to meet the needs of funds and human resources when SMTs adopting the diversified product line approach.

On the one hand, banking, insurance and other financial institutions can use the platform to expand the scope of the Trust to carry out mixed layout; On the other hand trust these institutions also need to use the capital, sales and service network, human resources and brand. If the advantages of mixed operation of SMTs combine with those large-scale financial institutions, which have large capital, brand, marketing services, personnel system, the synergies will be very substantial.

In fact, due to the promotion of innovation in trust industry by regulatory authorities, many large financial groups have show their great interest in trust industry, which could be the platform of mixed

³ Including: banking, insurance, securities companies and fund companies

operation have the scope of a wide range of investment. Recently, both parties involved in acquisition or share purchasing frequently (Table 2).

Table 2 The Situation of Large Financial Groups Purchasing Trust Share

Trust company	Large financial groups	Condition
Bairui trust	Haitong security	engaging
Hubei International Investment	Bank of Communications	finished
Zhongrong trust	Industrial and Commercial Bank of China	engaging
Zhejiang International Investment	Jiayin Investment	finished
shan International Investment	Minsheng Bank	finished
Zhongcheng trust	People's Insurance Group	engaging
Xinjiang International Investment	Huarong Asset	finished
Hefei Xingtai trust	Bank of Construction	finished
Tibet Trust	China Merchants Bank	engaging
Shanxi International Investment	HSBC Bank	engaging
Beijing International Investment	British Ashmore Investment	finished
CITIC Trust	Japan's Mitsubishi Trust and Banking	engaging
Xinhua Trust	Britain's Barclays Bank	finished
Lianhua Trust	National Australia Bank	finished
Jiangsu Trust	UBS, Merrill Lynch & Co.	stopped
Gongshang Trust	Morgan Stanley	finished
Suzhou Trust	Scotland royal bank	finished
The National Trust	HSBC Bank	stopped
Kunming International Investment	Macquarie Bank	engaging
Xiyou Trust	Merrill Lynch	stopped

For the SMTs, the integration with financial institutions is no doubt a chance of rapidly enhances their comprehensive strength. Need to be reminded that although the statistics show that integration of financial institutions is relatively low compared to other industry, as a long-term strategic choice, careful analysis is needed before any action. Analysis should include the basis of cooperation between the two sides, each party's idea of future development, the combination of human resources as well as financial resources, and the retained independency of management.

4 Conclusion

Based on the above analysis, in the face of the challenges of financial crisis, as well as fierce competition in the financial sector, survival and development is a clear and basic objective for SMTs, but most importantly the long term objective is to reduce the gap between SMTs and the industry leader as soon as possible.

To reach this long term strategic objective, obtaining new business licenses and raising the core competence is two inevitable choices of overall strategic planning of the SMTs. And the acquisition of new business licenses needs to upgrade the core competence to reach the qualification requirements of the new regulation. Thereby increasing the core competence is the core approach to achieve the strategic objectives that SMTs must adhere to no matter in what stages of strategy.

On the other hand, the improvement of Core competence requires the SMTs to change their strategic positioning from financing platform to the financial service provider. And the necessary approach to become a financial service provider is to realize a diversified product line.

Secondly, in order to grasp the opportunities brought by the financial crisis, and realize the

changing of the strategic positioning to narrowing the gap between SMTs and the industry leaders as soon as possible. Offering financial service to satisfy the governmental anti-crisis investment plan and integration with major financial institutions will be the short-term and long-term strategic approach the SMTs can not afford to miss.

The limitation of Timeliness is where the limitations of this article. Corporate strategy itself is not immutable, as the economic situation grows and competition changes, makes the appropriate adjustment to the strategy is necessary. Therefore, over time, the inevitable changes of the background upon which the strategic choice were analyzes will occur. Then, the strategic choice will need to be adjusted in the specific circumstances.

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