

# A Study on Innovative Development of Investment Banking from Risks Perspective based on the Research of Shanghai Pudong Development Bank (SPD)

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**Abstract.** There are two types of main investment bank development pattern, separated pattern and mixed pattern. As for the condition of SPD, the mixed pattern which is more businesslike is a better choice because China is still a developing country and its development demands an effective financial environment. Such a pattern can not only help the bank to implement operation of scale but reduce its risks, which enables the investment bank industries to spread widely in some ways. Meanwhile, the pattern will bring about healthy competition between banks and select the fittest. For instance, the investment bank which is also a universal bank in German has a strong hand to play with the investment bank in United States. Although the mixed pattern is likely to create chain reactions in the whole financial system, its advantage is more essential to SPD now.

**Keywords:** Investment bank, Shanghai Pudong Developing Bank, risk controlling strategies.

## 1. Introduction

An investment bank is a financial intermediary that performs a variety of services. Specializing in large and complex financial transactions such as underwriting, investment banks act as an intermediary between a securities issuer and the investing public as well as a broker and/or financial advisor for institutional clients, and facilitate mergers and other corporate reorganizations. SPD is a national joint-stock commercial bank whose head office is located in Shanghai.

The paper is going to give an introduction to the risks of developing investment bank in SPD by using historical data, analyzing financial reports, making comparison between it and its competitors, and searching related information online, whose goal is to explore specific measure of innovative business development. To begin with, it is necessary to analyze the necessity and feasibility of commercial banks' developing the investment bank. We will use SPD as an example to illustrate it. Secondly, this paper will demonstrate the current performance based on the analysis of financial statements. We will mainly use the data and statements from SPD's annual reports from 2013 to 2017.

## 2. Literature Review

### 2.1 The Necessity of Developing an Investment Bank

Developing an investment bank is a main strategic planning in SPD's future picture. Therefore, it is essential to dissect whether it is necessary to be developed. To achieve this goal, we are going to look through the performance of SPD from 2013 to 2017, as shown in table 1 and table 2.

By analyzing figures vertically, we can learn the financial trend generally, so we focus on the data about retained profit, leverage ratio and capital stocks from 2013 to 2017 (shown in table 1 and table 2). First, the retained profit was growing gradually at an average growth rate about 17%. Especially, from 2016 to 2017, it rose by 20,317 million RMB, rising about 21%. This result demonstrates that the investment bank plan which has been carried out for 10 years is helping the bank make more profits. Second, after calculating the leverage ratios, which exhibit the bank's ability to pay debts and value the relationship between the working capital and liabilities, we find out the results hovered around 0.94. A desirable result that all ratios were less than 1 was the bank had the ability to repay its debts, but the number was not ideal. Additionally, the capital stock of the bank in 5 years is shown in the graphs below. In general, the net profit grew inch by inch and the dividends per 10 shares of common stocks decreased, which means the common stocks were controlling less capital and the

parent company held more shares than before, hence the working capital increased for the parent company. However, it also means that there were less power and fewer interests for shareholders who held common stocks, which may cause some shareholders to sell their shares to seek higher repayment from other stocks.

Table 1. The company's profit distribution scheme or predetermined plan of common stock, and the transfer scheme or predetermined plan of transforming capital surplus into share capital from 2013 to 2015 (Unit: RMB million yuan)

Year	Number of bonus shares per 10 shares (shares)	Dividends per 10 shares (yuan) (shares included)	Number of transformed share premium per 10 shares (shares)	Amount of cash bonus (taxes included)	Net profits attributable to shareholders of the parent company in the consolidated statement of the dividend year	Ratio of net profit attributable to ordinary shareholders of the parent company in the consolidated statement (%)
2015	-	5.15	1	10,121	50,604	20.00
2014	-	7.57	-	14,121	47,026	30.03
2013	-	6.6	-	12,311	40,922	30.08

Note: The profit distribution plan of 2015 is still subject to review and approval by the shareholders meeting before execution.

Table 2. The company's profit distribution scheme or predetermined plan of common stock, and the scheme or predetermined plan of transforming capital surplus into share capital from 2015 to 2017 Unit: RMB million yuan

Year	Number of bonus shares per 10 shares (shares)	Dividends per 10 shares (yuan) (shares included)	Number of transformed share premium per 10 shares (shares)	Amount of cash bonus (taxes included)	Net profits attributable to ordinary shareholders of the parent company in the consolidated statement of the dividend year	Ratio of net profit attributable to ordinary shareholders of the parent company in the consolidated statement (%)
2017	-	1.00	-	2,935	54,258	5.41
2016	-	2.00	3	4,324	53,099	8.14
2015	-	5.15	1	10,121	50,604	20.00

Note: The profit distribution plan of 2017 is still subject to review and approval by the shareholders meeting before execution.

### 2.1.1 Risk

Ping A Bank is also a bank which is developing investment bank and one of competitors of SPD, which focuses more on individuals' investment. Unlike Ping An, SPD pays more attention on companies' programs. Ping A mainly provide services from two aspects, capitalization and trust, and it has ten kinds of plans in details. Compared with Ping An, SPD provides several plans involving three different areas: stocks, funds and cross broader trades. In general, SPD offers more choices for companies while Ping An is more suitable for individual investors.

### 2.1.2 Service

Stock exchange center integrated financial services

SPD adheres to the service concept of "sharing and growing together", bases on the fact that the stock exchange center business needs further research and deep understanding, and the integration of

financial products, services and resources. The bank conduct stock exchange center and the related participation main body provide comprehensive, integrated comprehensive financial services, including enterprise listed consultancy, privately raised company bonds—two key products, and equity financing, etc.

#### Comprehensive financial services

SPD refers to the study of the equity investment fund industry chain and a deep understanding, relying on the platform and resources of commercial Banks, based on accumulated in the equity investment and financing field of professional advantage and service advantages, adhering to “having a good faith and creating the excellence” service concept, based on characteristics of equity investment funds industry chain, to launch PE comprehensive financial services, including PE consulting service plan, PE financing support services project investment service solutions, PE investing and trust linkage service, etc.

#### Cross-border investment banking financial service

SPD cross-border financial services of investment banks, on the basis of the actual demand in enterprises, are fully integrated within the territory of SPD’s branches, overseas branches, offshore banking, free trade zone branch and Pu Yin international business resources, and combined with “the Belt and Road Initiative” strategy and overall strategy for the construction of Shanghai international financial center, giving full play to the SPD group, integration, internationalization operating advantages, targets of the enterprise to provide complementary products and services and meet the needs of different types of corporate diversification.

### 2.1.3 Trend

#### The feasibility of developing an investment bank

There is a bright future for investment banks. First, debt financing industry has been impacted by the financial crisis. Second, the revenue from mergers and acquisitions businesses is decreasing. Therefore, some businessmen are looking to other financing methods. Third, the trading volume doesn’t reduce, which means the investor’s confidence doesn’t be influenced. In addition, the Chinese government gives a hand to the contribution of investment bank by stimulating domestic demand and sustaining growth.

#### Foreign development

Investment banks in developed countries such as the United States and the United Kingdom have strong earnings and a lot of shares in business market. Many of them are implementing the globalization strategy in order to consolidating the original domestic market and growing overseas operations. Meanwhile, the scope of business of the western countries’ investment banks is getting wider and wider because they are making efforts to deliver different services. The complication and diversity mean that the foreign investment banks have formed a mature industry.

#### Financial Innovation theory

We are going to analyze the financial situation of SPD bank by using STEEP (society, technology, economy, environment and politics) analyzing method, mainly focusing on society, economy and politics aspects, and relevant financial ratios from SPD’s annual report.

## 3. Discussion

### 3.1 Society

The worldwide trend is investing in investment bank. Since financial crisis happened frequently in some countries, many investment agents become less trustworthy in clients’ minds. Meanwhile, investment bank industry is rising and gaining more and more concerns. Since banks in China are mostly business banks, they have responsibilities to combine investment banks’ characteristics.

### 3.2 Economy

The world’s economic situation requires a common bank to be a synthesis bank. It was harder for banks to gather funds before because banks’ interests are lower than people’s expectation and most

of citizens want to use spare money to do some investments for more profits. Therefore, banks take reactions to attract clients. The annual reports show that the revenue of SPD rose by 20,317 million RMB, proving that the investment bank services brought the bank more profits.

### **3.3 Politics**

The government encourages change in bank's operating methods as well as innovation in bank's services. China's economic development is changing from external demand driven to internal demand driven. Banks are supposed to adjust their operating methods and assets portfolio. They have to deliver unique investing programs and services to avoid imitated, so they can maintain competitive advantage and create more values for clients.

## **4. Theoretical Discussion**

There are two types of main investment bank development pattern, separated pattern and mixed pattern. As for the condition of SPD, the mixed pattern which is more businesslike is a better choice because China is still a developing country and its development demands an effective financial environment. Such a pattern can not only help the bank to implement operation of scale but reduce its risks, which enables the investment bank industries to spread widely in some ways. Meanwhile, the pattern will bring about healthy competition between banks and select the fittest. For instance, the investment bank which is also a universal bank in German has a strong hand to play with the investment bank in United States. Although the mixed pattern is likely to create chain reactions in the whole financial system, its advantage is more essential to SPD now.

## **5. Managerial Implications**

There are three meaningful suggestions for the investment bank to apply in its development. First, SPD should set a collaboration mechanism to optimize the business environment for the investment bank because the investment bank industry relies on organizational and problem-solving ability more than professional skills. All departments in SPD are supposed to work together and give supports to each other. Second, the managers have to transfer their thinking of risks and build up a new risk controlling system. The industry is risky so it is significant to give it flexibility in a range and assume the risk premium under certain risks. Therefore, managers need to create a new system to control risk properly and effectively. Third, to compete with other investment banks, SPD has to increase innovation and prevention relevant risks. In other words, it can encourage and reward employees who set new plans of providing different kinds of services. It is vital to break the tradition operating system, risk controlling system and institution settings.

There are five dimensions demand attention for risk controlling department. First, the transparency which is a requirement that the bank needs to show every asked detail to clients is necessary for containable contracts. Second, the objective and trustworthy risk management strategies and behaviors are needed to protect the safety of assets are conditions for high creditability. Third, as for timeliness, risk management measures must be based on a reasonable assessment of the degree of risk delay. Next, the effectiveness of risk management measures (process, judgment, model, tools) is related to the final asset quality, therefore, the measuring strategy should be specific and targeted. Additionally, risk management measures must meet the requirements of comprehensiveness, standardization and consistency, that is, the risk management needs to be systematic.

## **6. Conclusion**

To sum up, it is definitely a good choice for SPD and other commercial banks to develop investment banks under the current economic environment. Making more profits for the operation of the whole bank by developing investment bank is a trend. Banks need to dig their inside potential and integrate both inside and outside advantages to attract clients and promote their status.

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