

# the puelicher center

FOR BANKING EDUCATION

Spring 2006

## Bankers from Shanghai Pudong Development Bank Visit Puelicher Center

By Franklin West

The Puelicher Center and several mid-western banks recently hosted 10 senior bankers from the Shanghai Pudong Development Bank (SPDB) in China. Their purpose in visiting The Puelicher Center was to better understand how American banks approach the banking business.

### About the Bank and Banking Systems in China

Shanghai Pudong Development Bank is China's ninth largest commercial bank and was the first commercial bank to be listed on the Shanghai Stock Exchange. It was created 12 years ago with the objective of making Shanghai into an international economic, financial and trade center in the shortest possible time.

The bank has a nationwide network of 290 branches across 30 cities. Its 7,000-member staff provides financial services to both corporate and consumer clients. The bank is listed at No. 308 among the top 1,000 banks in the world in terms of core capital according to the British magazine, "The Banker," and is ranked No. 15 among the top-300 Asian commercial banks (first among domestic banks) by ROE, capital adequacy ratio, NPL ratio and increase in profits and assets by "Asian Banker" magazine. The bank has

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SCHOOL OF BUSINESS  
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also been nominated by "Asian Weekly" for four consecutive years as one of the top-100 listed companies in China (No 6 in 2003), with a total market value of about US \$1.7 billion.

One of the objectives of the People's Republic of China (i.e., China) is to create a free market banking system. SPDB is one of its first forays into this area, as it is a privately owned bank regulated by the state. In order to facilitate this transformation, China has allowed foreign banks in the past few years to invest in its major commercial banks.

The world has rightly marveled at China's dazzling growth, but the amount of money involved in pushing that expansion has been less well publicized. It takes \$5 to \$7 of investment to generate a dollar's worth of gross domestic product in China, vs. \$1 to \$2 in developed regions such as North America, Japan, and Western Europe. For now, China has both the enormous profits from its export trade and the captive savings of its citizens to invest. More than \$3 trillion in savings is inside Chinese banks, at quite low interest rates, because the country's capital controls and undeveloped capital markets prevent savers from investing it elsewhere.

Unfortunately, China's four biggest banks and thousands of local lenders have made a large number of loans that have become non performing. Beijing, to date, has spent some \$100 billion bailing out the Big Four - the Bank of China, China Construction Bank, the Industrial & Commercial Bank of China, and the Agricultural Bank of China. Standard & Poor's estimates the four will need an additional \$190 billion later this decade to stay above water.

Why are China's banks in such difficulty? Because for most of their history they weren't banks in the Western sense at all; rather, they were financing arms of the Chinese government.

**"The Puelicher Center is a popular destination for foreign bankers," says Fan Gang, president of the National Economic Research Institute.**

China's financial managers know the country's growth engine is at risk if it can't allocate capital more effectively. That's why they've developed a plan for each of the Big Four - which together make 57% of all corporate loans - to link up with one or more foreign banks between now and the end of 2006, when the banking system will be fully open to foreign investors. The idea is that the foreign stakeholders will lend their expertise and, among other reforms, help straighten out the big Chinese banks' loan books. Bank of America Corp. bought a 9% stake in China Construction Bank for \$3 billion, and on June 23, 2005 Switzerland's UBS announced it was in negotiations to make up to a \$500 million investment in Bank of China.

Analysts note, however, that the Big Four and their government overseers are unlikely to let foreign partners have much real control over management. There are a half-dozen younger, privately owned banks created in the late 1980s to help develop the "new China." These smaller banks are much more malleable reform vehicles, although even in those banks, "you really need an experienced management team" willing to try to improve things, as BusinessWeek Online wrote in its August 25, 2005 article, "The Great Bank Overhaul." Several of these "shareholding" banks have important foreign partners. For example, Citigroup owns a 5% interest in SPDB and is its largest single shareholder.

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## Reason for the Visit

All banks in China recognize that by the end of 2006 they will have to compete head on with other international banks, which, due to the WTO entry agreement with China, will be allowed to deal in local currency just like indigenous banks. SPDB executives are interested in seeing how other international banks are evaluated and how their management teams are approaching the future of banking. SPDB knows its world is changing and is trying to get its arms around that change.

## Johnson Bank Visit

The first morning's bank visit was to the Johnson Bank branch in west Madison. Ann Fink and Michael Smith had arranged for leaders from each of their major product lines to introduce and discuss their business strategies. The Chinese bankers were given a tour of the Johnson Bank facility and then listened to various department heads.

They seemed particularly impressed by Johnson Bank's ability to retain 98% of its customers once the bank had established a relationship with them. They were also impressed by the "integrated" strategy pursued by the relationship banker, who brought in various other specialists to service all the client's needs. Since SPDB currently relies heavily on commercial lending as its major product line, this integrated strategy was an important discussion point for them.

## Meeting with M&I and U.S. Bank Executives

In the afternoon, the Chinese bankers met with Gordon Gunnlaugsson, former CFO of M&I Bank; Paulette Klaffenboeck, V.P. of Global Banking at M&I; Peter Mortensen, SVP in Commercial Real

Estate at U.S. Bank; and Doug Rahn, SVP in Private Banking at U.S. Bank.

The U.S. Bank executives discussed how little fee income was being generated at SPDB. They pointed out the benefits of fee income, in particular, income from wealth management, as not requiring much funding or regulatory capital requirements. Doug Rahn spent considerable time discussing the overall strategy U.S. Bank pursues in helping clients maximize their wealth. Peter Mortensen also talked about the important role that commercial real estate lending should be playing in a newly "capitalistic" real estate market. (Buildings can be owned in China, but not the property on which they reside.)

Pauline Klaffenboeck from M&I Bank's Global Banking talked about the importance of global trade finance and foreign exchange to importers and exporters in the Midwest. The SPDB bankers were very interested in how she determined pricing strategy and had a lively discussion on that topic.

Gordon Gunnlaugsson talked about several "global" issues facing banks today, the primary one being the heavy emphasis on capital management. Another issue was how to fund the balance sheet and the key role of core deposits. The SPDB executives were very interested in this discussion, as their focus has been primarily asset growth.

## Western Analysis of SPDB

Franklin West, of the Puelicher Center staff (who speaks some Chinese), spent the next day providing a training course on what security analysts focus on when determining whether or not to recommend a bank's stock. Since SPDB is partially public and in the near future will be 20% owned by Citigroup, the bankers were very interested in comparing their bank

with their western competitors. In particular, they have not had to focus as much on how their return on equity compares with the return required by free market investors. During the class, SPDB was compared with J.P. Morgan Chase to see how various analysts' ratios etc. compared. There were a number of notable points made in analyzing SPDB's financial statements. A key point is that SPDB currently is only required to maintain 3% of assets as equity, about 1/2 the requirement in the U.S. While SPDB's ROE currently is about 15%, if it had to double its equity, its "true" ROE would pale in comparison to Western banks.

Another interesting point is that the rates on SPDB's loans and on their deposits are set centrally by the Peoples' Bank of China (the central bank), so they have very little interest rate risk. Since they only deal in RMB and U.S. dollars (for which the exchange rate is practically fixed), they have very little foreign exchange risk. As a result, the main risks they have to manage relate to the credit quality of their portfolio (which is significantly better than many of their peers in China.)

Overall, the SPDB bankers expressed appreciation of their visit here and their hosts enjoyed getting to know them and their culture better. The Puelicher Center was happy to be part of this educational and cultural exchange. The success of the visit, however, was due to the generous participation of Johnson Bank, U.S. Bank and M&I. who were all great hosts and educators.

## The Puelicher Center provided support for the following Quantitative & Mathematical Finance students:

Nicholas Byrne is from Port Washington, Wis. Nicholas has a BS in Mechanical Engineering from Valparaiso University in Indiana, a Masters of Science in Biomedical Engineering from UW-Madison and will receive his Quantitative Master's in Finance degree in May of 2007. Nicholas' interests are hedging and risk management, portfolio analytics and optimization, quantitative trading, and healthcare finance.



### Nicholas Byrne

Yilei Chen is from China. Yilei has a BS in Engineering Physics from Tsinghua University, an MS in Computer Science from Tsinghua University and will receive a QMF degree in 2007.



### Yilei Chen

Derek Leslie-Cook is from Seattle, Wash. Derek has a BS in Applied Computational Mathematical Sciences, BS in Economics, BS in Computer Science, all from the University of Washington, Seattle. He also has an MS degree in Economics from the University of Wisconsin-Madison. He will complete his QMF degree in May 2006. Derek would like a lead role as a quantitative developer within the financial services industry.

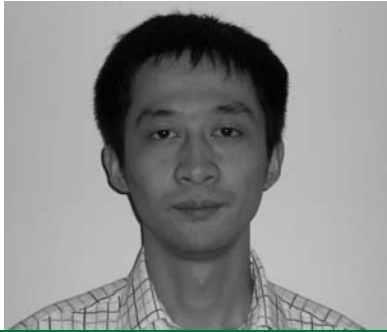


### Derek Leslie-Cook

Yajun Li is from China. Yajun has a BA and MA in Economics from Beijing University. Yajun, who attended the PhD program at the State University of New York-Albany, would like a career in the financial services industry. Yajun is expected to receive a QMF degree in spring of 2006.



### Yajun Li



Dajing Shang is from China. Dajing has a BA in Economics and a BS in Mathematics from Wuhan University in China, and an MS in Economics from the University of Wisconsin-Madison. He has completed course work in the PhD program in Economics at the University of Wisconsin-Madison. Dajing would like a job in quantitative modeling and statistic analysis in finance and would like to conduct research in the areas of asset allocation, derivative and fixed income pricing, risk management and security trading. Dajing is expected to receive his QMF degree in May of 2006.

## Dajing Shang

### Banking Course Remains Popular

Once again, the Puelicher Center is busy training future generations of bankers. The demand for the banking courses this year is so great that we had to add an extra section of the introductory banking course, Finance 410, Bank Management in the Spring semester. Professor Cramer is teaching the class and has 55 students.

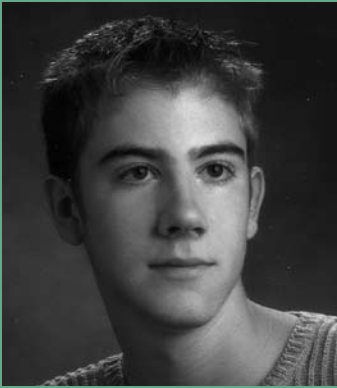
### Bank Simulation Going Strong

The advanced banking course, Finance 610, Bank Simulation and Strategy, is also a popular course for finance and accounting majors. This spring's class has 18 undergraduate students. The large enrollment will allow us to run a banking community of five banks. May the best team win.



1st row L-R, Bryan Johnson, Gabe Korach, Chris Kaszmarczyk, Charles Kauss; 2nd row, Peter Wirtala, Chris York, Matt Neis, Oscar Theiler, Steve Schultz; 3rd row, Pete Komassa, Chris Reger, Kristin Wiseman, Jeff Huss, Kendall Garrison, Michael Manuel, Joe McElroy, Jorgen Svensson; 4th row, Robert Cramer, Franklin West, James Johannes

# Puelicher Center Undergraduate Banking Scholarships



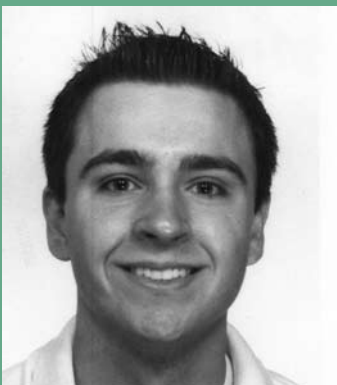
**Brian Abbott**

Brian hails from Wisconsin and is a double major in Finance, Investment and Banking and in International Business. He is a member of Alpha Kappa Psi, Sigma Iota Epsilon and Hoofers. Brian is fluent in Spanish and volunteers in the Hispanic community. He would like to become a CFO of a major corporation.



**Jill Derdzinski**

Jill is from Wisconsin and is a double major in Finance, Investment and Banking and in International Business. Jill is a member of the Finance and Investment Society, the International Business Student Association, a BRIDGE volunteer and a Conversational Language Partner. Jill would like to pursue a career in the financial services industry with an emphasis on investment banking.



**Kendall Garrison**

Kendall is from Eagon, Minn. He is a double major in Finance, Investment and Banking and in Management. He is on the Dean's List and he is in the School of Business Honors program. Kendall is a member of Sigma Phi Epsilon Fraternity, the Finance and Investment Society and the School of Business Student Faculty Board. Kendall would like a career in investment banking.

# Puelicher Center Undergraduate Banking Scholarships



**Jeffrey Huss**

Jeffrey is from Green Bay, Wis. He is a double major in Finance, Investment and Banking and in Real Estate. Jeffrey is in the Investment Banking Club, the Finance and Investment Society and the Real Estate Club. Jeffrey would like to pursue a career in investment banking.



**Peter Komassa**

Peter hails from Wisconsin and is a major in Finance. He is a member of Phi Kappa Phi Honor Society, the Finance and Investment Society and College Republicans. Peter would like a career in investment banking.



**Mariska Kwok**

Mariska is from Hong Kong. Mariska graduated in December of 2005. She attended Notre Dame, Cornell and Harvard during her summers. Mariska was on the Dean's list, Golden Key International Honor Society and the National Scholars Honor Society. Mariska can speak four languages. With her language skills, Mariska has pursued a career in global financial services.

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**Jennifer Rowntree**

Jennifer is from Wisconsin. She is a double major in Finance, Investment and Banking and in Marketing. Jennifer is a member of the Investment Banking Club, Student Faculty Board, Finance and Investment Society and Mu Kappa Tau. She is also a School of Business Student Ambassador. Jennifer hopes to pursue a career in the financial services industry, with an emphasis on healthcare finance.



**David Braun**

David is from Madison, Wisconsin. He earned his BBA (finance) from the University of Wisconsin-Madison in 2003. He is currently working at M&I as a Business Banking Officer. David is working on his MBA through the Evening MBA Program at the University of Wisconsin, School of business. He is active with the United Way of Dane County, the Mendota Gridiron Club, The National W Club, and Sauk Trails Optimist Club. David holds his Real Estate License in the State of Wisconsin and is pursuing his Brokers License.