

Risk Management and Managerial Efficiency in Chinese Banks: A Network DEA Framework

Kent Matthews

Cardiff University

Hong Kong Institute for Monetary Research

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Summary

Risk Management in Chinese banks has traditionally been the Cinderella of its internal functions. Political and developmental imperatives have in the past often overridden standard practice of risk management resulting in historically large non-performing loan (NPL) ratios. One of the stated aims of opening up the Chinese banks to foreign strategic investment is the development of risk management functions. NPL ratios have declined in recent years through a mixture of good recovery practice, operations of the asset management companies and expanded balance sheets.

However, the training and practice of risk managers remain second class compared with foreign banks operating in China. The objective of this paper is twofold. First it constructs an index of risk management practice and risk management organisation of selected Chinese banks. The index is obtained from interviews with risk managers and the completion of a semi-structured questionnaire where the managers are asked to score various factors relating to risk management, the organisation of the risk management in the bank and the training of risk managers.

The indices are used to evaluate bank performance using a Network DEA approach where the index of risk management practice and the index of risk management organisation are used as intermediate inputs in the production process. The results suggest that the risk indices have information content in that they can be used to evaluate bank performance. The use of network DEA can aid the manager in identifying the stages of production that need attention.