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Summary:
IN A manoeuvre sure to incite the envy of its peers, Citigroup is poised to become the first foreign bank, and only the second foreign investor, to gain control of a Chinese lender.

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Citigroup pushes at the limits to foreign ownership in Chinese banks

IN A manoeuvre sure to incite the envy of its peers, Citigroup is poised to become the first foreign bank, and only the second foreign investor, to gain control of a Chinese lender. The American financial-services giant is leading a consortium that has bid some 24 billion yuan ($3 billion) for an 85% stake in Guangdong Development Bank (GDB), a medium-sized bank from China's relatively rich south. Citigroup itself could own 40-45% of GDB if the deal proceeds, making a mockery of rules limiting a single foreign investor in a Chinese bank to 20% and all foreigners to 25%.

This would be a comeback for Citigroup, which for two years has had to sit and watch while rivals have grabbed strategic positions in the Chinese banking market. In June 2005 Bank of America (BofA) beat Citigroup to a 9% stake in China Construction Bank (CCB), one of the country's four biggest lenders. Citigroup even lost a profitable position advising on CCB's multi-billion-dollar flotation. This time it has moved faster, outbidding ABN Amro, of the Netherlands, and France's Société Générale for GDB. Although Newbridge Capital, a private-equity firm, was the first foreign investor to gain management control of a Chinese bank, its charge, Shenzhen Development Bank, is barely half the size of GDB, which had assets of 345 billion yuan at the end of 2004.

Citigroup is, however, paying a high price: 2.3 times book value, compared with the 1.15 times BofA paid for its slice of CCB. True, acquirers often pay a premium for control. But GDB's financial state is precarious. Its liabilities exceed its assets by 35 billion yuan (state subsidies have propped it up); its capital-adequacy ratio is way below international standards; and its profitability is poor.

Moreover, to proceed with the deal Citigroup is being forced to restructure another, and at a price. In early 2003 the Americans bought 4.6% of Shanghai Pudong Development Bank, a middle-sized lender that insiders say is proving a prickly partner. Citigroup promised then not to invest in another mainland bank without Shanghai Pudong's permission. That has been granted, but only on condition that Citigroup raise its stake in the Shanghai bank to 19.9% at a rumoured cost of $800m, four times the original price per share. Remarkably, Citigroup also had to agree not to set up a joint-venture with GDB in credit cards, China's most promising financial business and the only one the Guangdong bank appears to be any good at.

Still, Citigroup's rivals will surely cry foul. By last October, 22 foreign banks had spent $16.5 billion on stakes in 17 mainland lenders, but had gained little real influence. The Chinese authorities will argue that GDB's poor state and smallish size make it an exception. And Liu Mingkang, the banking regulator, gave warning last month that should foreigners be granted more than a quarter of a Chinese bank, that bank would then be considered foreign, subject to restrictions that, among other things, allow yuan-denominated business in only a few cities. Still, he will now come under pressure to raise the caps on foreigners' stakes. That might allow the likes of HSBC, with 19.9% in BoCom, a larger and far sounder bank than GDB, to gain real management control. Inadvertently, Citigroup's coup may end up profiting its rivals more than itself.