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Article

State Bank Privatization: The Role of The China Model and Strategic Directions for Expanding Participation in The Securities Market

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Abstract: The transformation and privatization of state-owned banks play a pivotal role in fostering financial stability, improving competitiveness, and expanding capital market participation, particularly in developing economies seeking to modernize their banking systems. Uzbekistan, like many transitioning economies, is undergoing reforms to align its banking sector with global market standards. The state's dominant position in the financial sector is being re-evaluated through policy measures guided by international experience, especially the strategic "China Model" of bank privatization. Despite growing global interest, there is limited empirical research on the strategic sequencing and effectiveness of privatization models specifically tailored to developing markets, especially concerning the role of state banks in the securities market. This study aims to examine strategic directions for expanding state banks' participation in the securities market during privatization and assess the applicability of the China Model to Uzbekistan's context. The analysis highlights key areas including institutional reform, public IPOs, restructuring before divestment, and prudential supervision. Empirical data show that staged IPOs, improved governance, and foreign strategic investment enhance transparency and competitiveness. The Chinese model, with its blend of state oversight and market participation, has proven effective in boosting bank performance and reducing non-performing loans. The study introduces a comparative framework for evaluating state bank privatization strategies with emphasis on the role of securities markets, drawing actionable lessons from China's hybrid model for broader applicability. Findings inform policymakers on balancing efficiency and control during bank privatization. Strategic sequencing, regulatory integrity, and inclusive capital market development are crucial for ensuring successful outcomes in the privatization of state-owned banks.

Keywords: Public Offering of Shares, IPO, Strategy, Securities Market, Stock, Transformation, "China Model" of State Bank Privatization

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1. Introduction

Among the tasks to be carried out in the reform of our country's banking system is the deep transformation of banking activities, management processes, and business processes. Efforts in this area aim to improve the competitive environment within the banking system, transform state banks, review their operations based on the market principles of developed countries and current demands, and, most importantly, expand the participation of private capital in the banking system. To achieve this, it is necessary to ensure the financial stability and efficiency of the banking system, establish commercial banks as active financial intermediaries in the securities market during the economic development process, provide high-quality and modern banking services to customers, and create a purely competitive environment.

The success of state banks in competitive struggles is directly linked to the ability of their leaders to make effective, strategically sound, and well-thought-out management decisions. In the current market conditions, the leader of each credit institution must respond promptly and adequately to changes in demand, consumer prices, quality of service, the creation of advanced banking technologies, and the introduction of digital marketing activities. However, for a long time, not only credit institutions but also organizations in general, have not sufficiently assessed the importance of research into the development of state banks' activities in the securities market. Based on this approach, stakeholders, until recently, did not allocate sufficient funds for financing this activity, either through the organization itself or by engaging external marketing or consulting agencies.

Currently, research on the transformation of state banks has a steady growth trend in costs, as the allocated funds are directly proportional to the number of new customers attracted and the retention of existing ones. In the context of the globalization of banking services, the reduction in the number of potential clients, and increased competition, privatizing state banks is becoming increasingly risky.

Therefore, it is important for our country to implement the privatization process of state banks within the established deadlines. Even Japan, a leading country in this area, faced shortcomings in implementing privatization through the extensive adoption of new technologies in the banking sector. Specifically, "Although Japan purchased technologies in the banking sector, due to its failure to create its own manufacturing networks in this area and maintain a consistently high level of technical developments, it lost its leading position in the digital economy through the privatization of banks".

The Decree of the President of the Republic of Uzbekistan No. PF-5992 dated May 12, 2020, on the "Strategy for Reforming the Banking System of the Republic of Uzbekistan for 2020–2025," as well as the Resolution No. 3620 of the President of the Republic of Uzbekistan dated March 23, 2018, on "Additional Measures to Increase the Popularity of Banking Services," define tasks for the banking system, including the introduction of modern information technologies, expanding remote banking services, including contactless payments, the use of automated scoring systems, digital identification, and the extensive use of credit conveyors, strengthening information security for bank data and systems, and implementing new concepts and technologies in the banking sector (fintech, marketplaces, digital banking).

By implementing these tasks, the banking system of our country will increase the acceleration of the privatization process of state banks, which, as of November 1, 2024, accounted for 69.5% of loans, 50.2% of total deposits, 68.7% of assets, and 69.2% of liabilities.

Accelerating the privatization process of state banks is advisable in the activities of our country, as can be seen from the experience of many advanced countries.

Literature Review: In general, it can be observed that many studies have been conducted on the issues of evaluating the activities of state banks in the securities market and increasing their strategic significance in this market during privatization [1]. Research conducted by Japanese scholars has studied the impact of privatization of state banks on market equilibrium [2]. Specifically, according to their analysis, "The conclusion that privatizing state banks has a positive effect on the market suggests that our analysis shows that privatizing the postal savings bank leads to increased efficiency by enhancing competition with private banks [3]. Moreover, they identified that the negative impact of privatizing postal savings banks is significantly stronger for regional and rural banks"[4]. In other words, privatization poses a risk for regional banks, which once had a regional monopoly, and it can be argued that, due to increased competition, rural consumers began to utilize various financial products offered by both private banks and privatized postal savings banks [5].

This result indicates that privatization has led to the expansion of consumer choice in rural areas of Japan [6]. Subsequent studies have shown that "Privatization of banks in transition economies represents a distinct case, significantly different from the privatization of non-financial enterprises [7]. Cement companies can still produce and sell cement, but banks in developing countries, as service providers for planned resource allocation, will have less demand in a market economy" [8].

According to scholars, state banks require more profound reforms compared to non-financial enterprises, as their main economic function must be entirely reconsidered when preparing for privatization [9].

From the perspective of the economic transformations taking place in some countries, "The optimal policy for governments with financial institutions - considering the poor performance of these institutions worldwide - is to privatize them [10]. This approach not only helps governments save money by eliminating subsidies but also enhances the efficiency of their economies by ensuring credit is provided through the market rather than through government officials"[11]. According to researchers, the full implementation of this process may lead to more effective management of banks after the privatization process.

In various countries, the necessity of privatizing state banks is recognized, yet the state itself remains the main opponent of this process [12]. Many countries around the world have significant participation in the financial sector. This is especially evident in the banking sector, where, despite a number of privatization initiatives carried out over the last decade, state-owned banks still hold a substantial share of the total banking sector assets [13]. "State intervention in the banking sector is not limited to ownership, but also encompasses, albeit to a lesser extent, insurance and contractual savings schemes. Moreover, while state intervention is often more prominent in developing countries, it can still play a significant role in the developed world and manifests in various forms"[14].

State banks often have non-performing assets and high costs, contributing only a limited share to development. Improving their performance is crucial, as despite the rapid privatization of banks in the 1990s, state banks still dominate the banking sector for the majority of the population in developing countries. In 2002, these banks held 60% or more of the banking assets in Algeria, Bangladesh, China, Egypt, Ethiopia, India, Indonesia, Iran, and Vietnam. In Latin America, privatization reduced the role of state banks, but they remain significant in Argentina, Brazil, Ecuador, and Uruguay [15].

When evaluating the activities of state banks in the securities market during privatization, scholars believe that "the main process that requires attention is ensuring that the market value of bank shares is higher than their nominal value". Scholars emphasize that achieving this result before the privatization process of state banks is crucial.

Some studies emphasize that "bank shares should be the most important tool in the privatization process". According to them, the more attractive the bank shares are, the easier it will be for them to be sold to investors.

When conducting a deep analysis of the theoretical foundations mentioned above, it becomes evident that special attention should be given to the processes related to the shares, which are most actively traded in the securities market during the privatization process of state banks.

2. Materials and Methods

Based on our analysis, we concluded that the "China Model" of privatizing large financial institutions has been very successful for China. We believe that similar models should also be considered in other developing countries, as it ensures a balance between effective monitoring and maintaining the competitiveness of these institutions in the market. The "too big to fail" institutions in developed countries took on excessive risks due to improper incentives, and their collapse triggered the most severe financial and economic crisis since the Great Depression. There is ongoing debate about how to regulate and control these large institutions without excessive oversight. In developing countries, the proper monitoring of large financial institutions is of particular importance, as the banking sector plays a more critical role in supporting economic growth compared to financial markets in many countries. However, this task could be challenging in the developing world, characterized by complex institutional investors and underdeveloped markets and institutions. In such conditions, we believe that the China Model of managing large institutions could be particularly relevant.

3. Results and Discussion

During the transformation and privatization of the banking system, the aim is to fill the economic gaps that arise, meet the financial service demands of all population segments, ensure the regional coverage of banking services, and implement the state's social and economic policies. To achieve these goals, state participation will be maintained in three banks – the National Bank, "Agrobank", and "Microcredit bank".

"Uzpromstroy bank", "Asaka bank", "Ipoteka-bank", "Aloqa bank", "Turon bank" and "Kishlok Qurilish Bank" are being prepared for privatization. It is planned that the state's share in at least one large bank will be fully sold to strategic investors.

The experience of privatizing banks in international practice is not about "how to do it", but rather in the form of widely established principles, as each case has its own unique characteristics. There are many similarities between the privatization of banks and non-financial enterprises, but it is also necessary to point out some key differences. The failure of a privatized bank causes more damage than the failure of a non-financial enterprise due to the loss of depositors' funds, disruption of the payment system, and potential impact on other banks. For these reasons, the relevant institutional structure, including strong foundations of general commercial legislation and effective banking supervision, is of critical importance. In the privatization process, the banking supervisory body should play a central role, as it is essential for reviewing and approving any proposals to change the ownership rights of a bank.

State banks may benefit from real or presumed special privileges. For example, depositors may consider their deposits to be directly guaranteed by the state. As a clear indicator of the end of implicit guarantees, it may be necessary to introduce a form of limited deposit insurance before privatizing state banks. Failing to address the special positions of state banks before privatization may create a risk of continued state support in the markets, which provides a competitive advantage to the privatized bank and increases potential political pressure for bank bailouts. A privatized bank may later face difficulties. The strategy for further enhancing the activity of state banks in the securities market during privatization should include the following key elements:

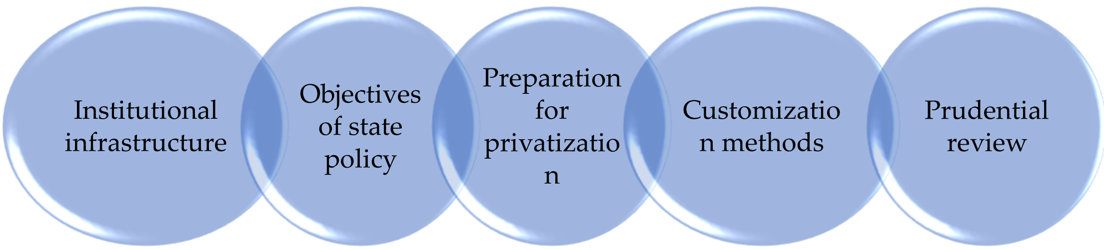

Figure 1. Key Directions in The Strategy for Further Enhancing The Activity of State Banks in The Securities Market During Privatization.

The strategic priorities for expanding state banks' activity in the securities market during the privatization process are effectively synthesized in Figure 1, which outlines the key directions to guide this transformation. Figure 1 highlights five core pillars: (1) the strengthening of institutional infrastructure, (2) alignment with state policy objectives, (3) thorough preparation prior to privatization, (4) the adoption of diverse and staged privatization methods such as IPOs, and (5) the implementation of prudential regulatory reviews. These components form an interconnected strategy designed to ensure that state banks become competitive and transparent participants in the capital market. The figure reinforces that successful privatization depends not only on divestment itself but on systemic preparation and regulatory coherence, especially within developing financial environments.

First, the institutional infrastructure alone, in the context of ownership change, cannot resolve many factors that contribute to the poor performance of state banks. The institutional factors reflected in the initial conditions of the Basel core principles of effective bank supervision should assist in the healthy operation of banks. These factors include a stable macroeconomic policy, a legal infrastructure, particularly legislation on contracts and measures to enforce collateral and security agreements, as well as relevant and widely applied accounting standards. In countries where these conditions need strengthening, successful privatization of banks should be part of a broader reform program.

Second, the goals of government policy in aiming for the privatization of banks often stem from the belief that private ownership contributes to financial stability and long-term growth. At the same time, some or all of the general objectives of privatization—such as increasing revenues, improving efficiency, encouraging wider ownership of shares, enhancing competition, and introducing market discipline—also apply to the privatization of banks. These goals of government policy can affect the preparation for privatization and the transaction itself, which could potentially conflict with issues related to financial stability.

Privatization is not solely about establishing a reliable and trustworthy financial system. Prudential issues should not become other policy goals due to the potential impact of future bank failures.

Preparing a bank for privatization: If possible, “same as” sales are preferable as they can be completed quickly and do not require significant state investments for preparing the bank for privatization. However, state banks are often in such poor condition that financial restructuring is necessary to attract reputable private investors.

Third, preparation for privatization involves the critical question of whether the state bank should be reorganized beforehand or whether the state’s stake should be sold "as is." In rare cases, where a state bank operates effectively on a commercial basis, there may be no need for operational or financial restructuring as part of the state investment process. However, in the usual case, state banks require serious restructuring to be fully competitive with private banks.

Fourth, regarding privatization methods, the literature provides several taxonomies of privatization methods, but almost all bank privatizations can be classified as selling shares, selling assets, or voucher privatization. The majority of bank privatizations are carried out through some form of share sale, and staged privatization often begins with an IPO or private placement, followed by secondary offerings. Privatization is not an event but a process, so while it is typical to classify by the type of transaction, there are many decisions that lead to the final choice of how to divest the state's stake. These decisions are linked to policy goals, political, and fiscal constraints. Privatization cases through the sale of bank assets are rare.

So far, the most common form of bank privatization involves the sale of shares, which can be done through a public offering, tender, or auction. The choice of method for selling shares is typically influenced by a number of sometimes conflicting objectives.

Maximizing state revenues can be achieved through staged privatization, but this needs to be balanced with the difficulties that may arise when the government retains a significant ownership stake, especially when establishing market-oriented management and governance in banks.

Some experts believe that plans should complement the strategic scheme of privatization and should not be considered separately. Many believe that foreign strategic investments are the most reliable method of privatization, as they allow the use of external expertise. Another form of privatization is offering shares to the public through an initial public offering (IPO). To date, thirty-three out of eighty countries not members of the Organization for Economic Cooperation and Development (OECD) have privatized 156 state banks. According to research conducted by Fred Huibers, a global leader in equity capital markets at ING Barings, initial public offerings account for 44% of all privatizations of banks in developing countries.

Privatization Through an Initial Public Offering has Several Advantages

Firstly, these offerings help develop local stock markets, as privatized institutions become the largest companies on these exchanges. However, this effect is not automatic, and the distortion of markets in privatization vouchers has marked part of these efforts. Developed stock exchanges, in turn, facilitate access to capital for other types of local businesses, thereby improving overall economic growth. Although, as a rule, governments can earn more revenue by selling shares to multiple investors rather than a single strategic investor (especially if primary public offerings are made when market prices are high), empirical research shows that governments tend to lower the price of their shares by attracting citizens to participate in the shareholder society. However, this outcome also has potential significant benefits: by encouraging broader ownership of privatized companies among many investors, primary public offerings effectively reform governments' ability to later renationalize institutions.

A widely used method in privatization is the IPO, which can be politically attractive as a way to maintain internal ownership, avoid errors in lending to parties connected with the bank's major shareholders, and also help develop the capital market by offering a large listing of local shares. However, broad ownership has drawbacks, such as not ensuring strong control over management by key shareholders, and it does not provide a natural route to strengthen management and internal systems of the bank following the sale of a controlling stake to a strong bank.

Privatization through an IPO may lead to disappointment in countries with small and developing capital markets. Underdeveloped institutional structures, such as inexperienced investment banks, limited brokerage networks, and trading mechanisms, may, in the worst case, lead to market manipulation, or at best, result in inefficient allocation of shares. Countries attempting to use privatization to develop their capital markets may be disillusioned by IPO prices.

China has used the IPO as an effective method to reduce the state's stake in the banking system, increase transparency, and attract new resources to develop the sector. The initial public offerings of shares in China's large state-owned banks have become the main driving force in the local primary offering market, and, beyond banks, the state has also privatized stakes in other assets through IPOs.

The results of empirical research show that privatization leads to good financial performance when a strong financial institution is attracted as a key shareholder. Ensuring the presence of a relevant key investor can be achieved through a sale via tender or IPO, or by maintaining control through a qualified investor beforehand. However, in developing and transitioning economies, such deals can be politically difficult because the only suitable strategic investors may be foreign. There is empirical evidence supporting the assumption that the entry of foreign banks can make local markets more efficient by forcing local banks to operate more effectively, and by offering long-term benefits in the form of intermediary services and fees for bank customers. This indicates that advanced foreign banks, as strategic investors, are considered appropriate for privatizing markets dominated by local banks, despite potential political resistance to selling to foreign interests.

Fifth, if appropriate prudential checks are conducted before privatization, many situations where the privatized bank faces financial difficulties later can be avoided. The question of how state banks and their privatization affect the stability and growth of the financial sector remains an important issue for policymakers. Despite many privatizations in recent years, state-owned banks still play an important role in the financial sectors of many countries.

State banks are often linked to significant shortcomings in the initial conditions for an effective banking system, such as the rule of law and a strong state infrastructure. Therefore, any specific issues raised by state banks may be obscured by these important institutional weaknesses. This conclusion aligns with the observation that large privatizations only occur before a crisis in a few cases. In these countries, the failure to create institutional conditions for strong banking performance before or at least simultaneously with privatizations is more likely to be a major cause of the crisis.

More research can help policymakers when working with state banks. A systematic set of examples organized around topics such as institutional infrastructure, state policy goals, preparation for privatization, privatization methods, and prudential review can lead to improved “how-to” recommendations for policymakers.

There are various ways of privatization, but each has its advantages and risks. Privatized banks achieve the best results when sold to a single strategic investor; however, this course of action carries significant political risks. For example, in the early 1990s, in Mexico's first phase of bank privatization, banks expanded very quickly—behind a wall of protection from foreign competition—and later needed to be re-nationalized. Similar issues exist in other countries, particularly in Eastern Europe, highlighting the importance of a strong regulatory and legal framework for private banks.

Research conducted by the World Bank’s prominent economists Robert J. Cull and George Clarke, and Institute President Mary Shirley, shows that when foreigners are not allowed to participate in the tender process, governments may earn less revenue from privatization and privatization processes. The lack of financial sector expertise from foreign institutions can lead to the loss of bank know-how and skills that could benefit many economies.

According to Clark, Cull, and Shirley, even if privatization is carried out, it should not be partially implemented. If the government still retains a portion of the shares, especially a large portion, banks are likely to continue underperforming with traditional financial measures. Another method of privatizing banks is selling them partially or fully to employee stock ownership plans. To date, twenty countries have used this method, although these plans tend to involve only minority shares alongside other private investors.

The privatization process of the Industrial and Commercial Bank of China (ICBC), the world’s largest bank by market capitalization, and its secondary public offerings (IPOs) on the Hong Kong Stock Exchange (HKSE) and Shanghai Stock Exchange (SHSE) have been noteworthy. The largest shareholder of ICBC is the Chinese government, while foreign institutional investors hold minority stakes. Many other large financial institutions have undergone similar reform processes and have similar ownership structures after their IPOs.

The “Chinese model” of privatizing large financial institutions may also be beneficial in other developing countries, as it ensures a balance between effective monitoring and maintaining the competitiveness of these institutions in the market. For many years, several large but inefficient financial institutions have dominated China's intermediary sector. The four largest state-owned commercial banks (the "Big Four" banks) have branches nationwide and control the majority of assets in the banking system. Prior to the crisis, the biggest issue in the banking sector was the high level of non-performing loans (NPLs), which accumulated in the "Big Four" banks due to poor decisions in lending to state-owned enterprises (SOEs).

The model's uniqueness lies in the partial privatization of large state financial institutions and their listing, with a company base that attracts different types of investors while the government retains the majority stake-this approach can be applied in other developing economies.

Before the IPO, ICBC implemented several phases of reforms aimed at establishing efficient operations, sound corporate governance, and modern risk management systems. For example, ICBC transformed its customer-oriented business activities, including corporate and personal banking, as well as treasury operations, along with centralized capital and financial management supported by better reporting platforms and a comprehensive review system.

ICBC was listed on the HKSE and SHSE on October 27, 2006. By that time, it was the world's largest IPO, valued at $21.9 billion. ICBC raised $14 billion (H-shares) in Hong Kong and another $5.1 billion (A-shares) in Shanghai. Due to a large number of subscribers, all the Green Shoe options (over-allotment options) for the allocation of shares were exercised by the investment banks. At the end of the first trading day, ICBC shares closed nearly 15% higher in Hong Kong, and its first-week return was 17%. Meanwhile, ICBC's A-shares listed in Shanghai saw a more modest increase of 5.1% on the first day and 4.8% in the first week. After the IPO, ICBC continued to improve its operational performance. In the first year after the IPO, ICBC's net profit grew by approximately 60%, which was higher than the average growth rate of 30% in profitability in the year before the IPO. During the post-IPO period from 2006 to 2010, ICBC's total assets and profits (both gross and net) grew at a rapid pace, while the NPL (Non-Performing Loan) ratios steadily declined.

To substantiate the key conclusion that the "Chinese model" of privatizing large financial institutions is applicable to other developing countries, it can be shown that privatized Chinese institutions outperform their competitors in other developing countries. Therefore, China's top five largest state-owned banks, including ICBC, can be compared with other large banks in developing and developed markets.

The "Chinese model" of privatizing state banks involves a series of reforms aimed at improving the operational efficiency of the banks, listing them on foreign (and local) stock exchanges, and involving minority shareholders. We have examined how this privatization model has been successful in increasing bank profitability and reducing NPLs. Additionally, these publicly listed banks can take risks similar to non-state banks in other developing and developed markets. Based on these results, it can be suggested that such a model of reforming and privatizing large financial institutions could also be considered in other developing economies.

4. Conclusion

Based on the analysis, the following conclusions and recommendations have been developed to outline important strategic directions for accelerating the privatization processes of state banks and expanding their participation in the securities market:

1. The "China model" of state bank privatization is based on improving the operational efficiency of banks and implementing their IPO listings on foreign (and local) stock exchanges.
2. Key strategic directions for expanding participation in the securities market during the privatization of state banks include their institutional structure, the objectives of state

policy, the preparation process for privatization, privatization methods, and implementation through prudential reviews.

3. In privatization strategies, it is recommended to apply a mixed model to benefit from the advantages of each approach. In the mixed model, the role of the strategic investor is crucial, and it is suggested that the selection process should follow a transparent and strict procedure while creating an open environment for foreign investors.
4. It is proposed to carry out privatization in phases by reducing the share of state banks in total loans, deposits, assets, and liabilities to 45%.

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